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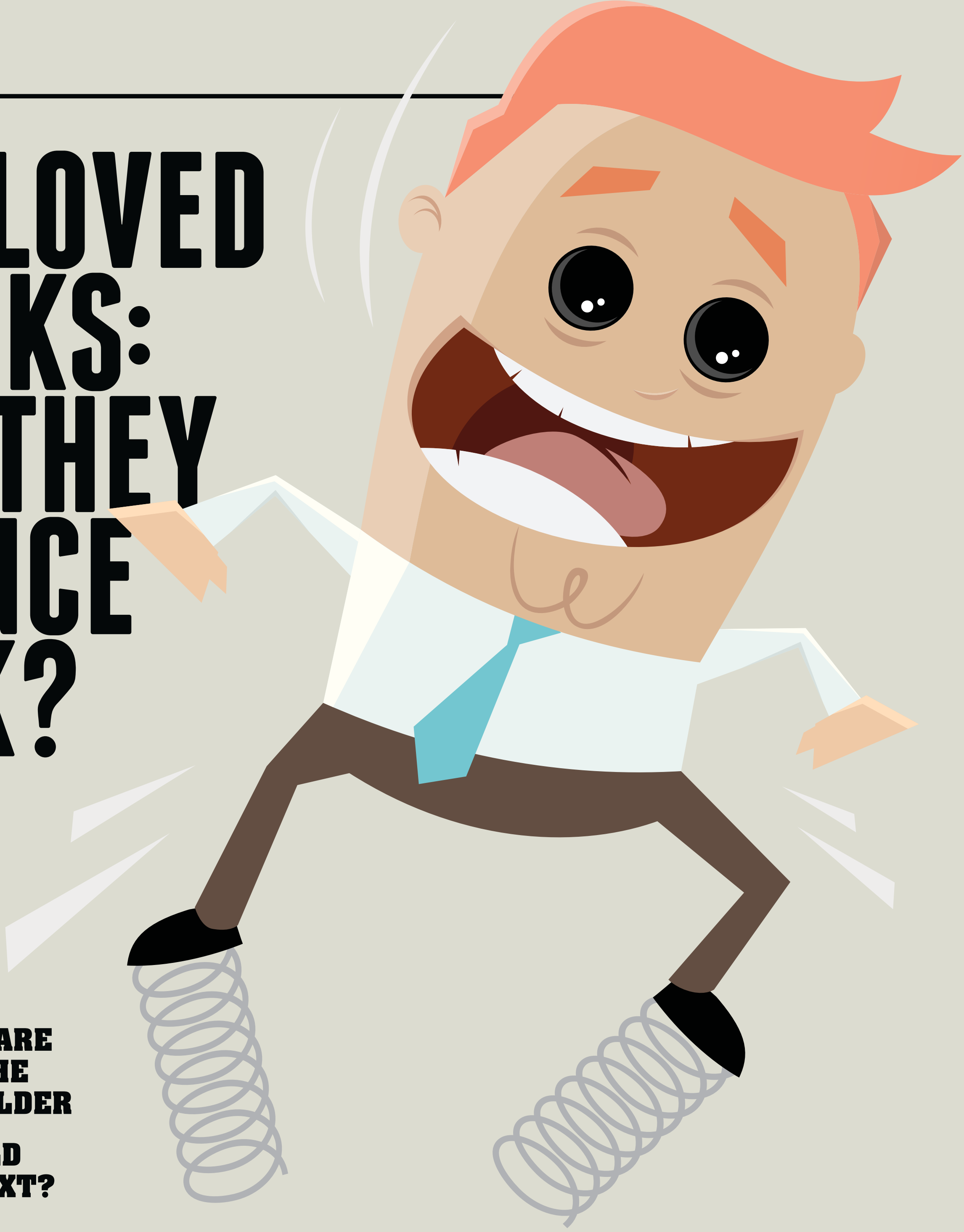
SHARES

WE MAKE INVESTING EASIER

7 UNLOVED STOCKS: CAN THEY BOUNCE BACK?



- WHY THEY ARE GETTING THE COLD SHOULDER
- WHAT COULD HAPPEN NEXT?

PLUS

HOUSEBUILDER SHARES HIT BY **PRICE SHOCK**

POPULAR INVESTMENTS IN JUNIOR ISAS

ALL EYES ON **VIDEO ADVERTISING PLAYERS**

Video ad experts could be on the FAANGs' radar

Broadcasters with video-on-demand and advertising companies with digital outdoor capabilities are areas to monitor in 2019

A lot of attention has been given to Google and Facebook as being core players in the world of advertising. Their platforms are, without doubt, extremely powerful given immense engagement with people around the world.

These companies, alongside Amazon, Apple and Netflix, make up the 'FAANGs' empire of firms which have a stronghold in the media sector, alongside other industries in several cases.

Of this group, many questions have been asked about the ability of Facebook and Netflix to sustain the level of growth required to justify their high share price ratings.

Facebook would need to take a huge share of global advertising to justify its equity rating, argues investment bank Liberum. It says the same goes for Netflix which needs to secure a continuous stream of new subscribers to justify the large amount of money it spends on content.

In Liberum's view, one potential solution to their problem may be to acquire traditional media companies as a means of improving their advertising reach. Video is seen as particularly important to these types of companies as there is a big shift from money being spent on internet banners and classifieds towards video advertising.

Free-to-air broadcasters and outdoor advertising companies come into focus as many have new digital formats.

It is becoming commonplace to see an advertisement before you stream a film or TV content online. Video displays are also increasingly replacing traditional billboards or other display formats in places like transport hubs, shopping centres and high streets. They can provide more effective targeting as messages can change throughout the day.

Stockbroker Numis says the UK out-of-home (aka outdoor) advertising industry was worth £1.1bn in 2017, of which 46% of revenue was digital, up from 19% in 2012.

Broadcasters have invested heavily in formats that boost video-on-demand advertising engagement, plus viewer response to this format can easily be tracked. Learning how individuals react to certain advertisements plays to the strengths of Facebook and Netflix as their business models involve incredible amounts of data analysis.

They are experts at pushing relevant content, be it adverts or shows/films, to the right people, so one can see the logic in them potentially wanting to own a traditional media business as it would give them another growth leg.

The wheels could already be in motion. There was speculation earlier this year that Netflix was in talks to buy US billboard company Regency Outdoor as a way of accelerating its marketing and have access to the advertising inventory it desires. Alibaba – known to many as the Chinese version of Ebay – recently took a minority stake in advertising display group Focus Media.

Anyone looking for relevant London-listed stocks in this space should note that shares in **Ocean Outdoor (OOUT)** are expected to start trading by the end of the year, having reversed into cash shell Ocelot.

Ocean Outdoor runs the iconic display board in London's Piccadilly Circus, as well as prominent outdoor advertising locations such as London's IMAX and external displays at the two biggest shopping centres in the UK by spend, namely the Stratford and Shepherd's Bush Westfield sites. (DC)

In Japan you need to look past the noise.

LET'S TALK HOW.

FIDELITY JAPAN TRUST PLC

With over 3,500 listed companies, there's a lot of financial noise on the streets of Japan. That can be deafening to untrained ears.

Through a hands-on research process, Nicholas Price and our team of analysts hone in on stocks with something to shout about that haven't been picked up by other investors. These opportunities are often found in smaller and medium-sized companies not frequently visited by analysts, although they could also be found in other areas of the market.

PAST PERFORMANCE

	Aug 13 – Aug 14	Aug 14 – Aug 15	Aug 15 – Aug 16	Aug 16 – Aug 17	Aug 17 – Aug 18
Net asset value	10.2%	12.9%	15.1%	32.0%	22.7%
Share price	7.7%	10.7%	22.6%	26.3%	21.4%
TSE TOPIX Total Return Index	11.4%	23.5%	4.1%	9.4%	11.1%

Past performance is not a reliable indicator of future returns.
Source: Morningstar as 31.08.2018, bid-bid, net income reinvested. ©2018 Morningstar Inc. All rights reserved. The TSE TOPIX Total Return Index is the comparative index of the investment trust.

So if the growth prospects of the world's third-largest stock market sound appealing, listen to your instincts and discover more about Fidelity Japan Trust PLC.

The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility. This trust invests more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies.

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Housebuilder shares in bleak territory amid property price shock

Three different sources of property data point to troubling market conditions

The latest Rightmove house price survey has added to the gloom surrounding UK housebuilders which have also been caught up in Brexit-related market concerns.

The average UK asking price this month is £5,200 or 1.7% lower than October at £302,000, according to Rightmove. This is the biggest drop in prices for the month of November since 2012.

Worse, on a year-on-year basis prices are down 0.2% in November, the first negative annual reading for seven years.

Anyone owning shares in housebuilders will have endured a difficult time in 2018, as illustrated by the accompanying table.

The last Halifax house price survey for October showed that annual growth last month was the slowest in five years at 1.5% while the Nationwide survey showed growth at its slowest since May 2013 although in both cases it was still positive.

All three surveys point to average house prices peaking in July then falling slowly over the summer.

The surveys all suggest that first-time buyer transactions are picking up slightly but they all show this being offset by a dramatic drop in buy-to-let demand.

This is due to a combination of a less-favourable tax treatment, tougher underwriting standards by mortgage lenders and lower demand for rented accommodation.

Regionally, London and the South East have been the weakest areas for some time but East Anglia and the South West have also slipped of late. According to the Rightmove survey every region of the UK has seen price falls in November.

With the supply of new houses tight, interest rates still at affordable levels, unemployment at a 40-year low and wages rising faster than consumer prices these should be salad days for companies linked to the property market.

Instead falling prices are putting punters off and buy-to-let, which looks to have been one of the biggest drivers of the market over the last seven years, seems to be in retreat. (IC)

HOUSEBUILDER	ONE WEEK CHANGE	YEAR-TO-DATE CHANGE
CREST NICHOLSON	-4%	-38%
TAYLOR WIMPEY	-12%	-30%
BARRATT DEVELOPMENTS	-12%	-26%
PERSIMMON	-13%	-24%
REDROW	-11%	-23%
BOVIS HOMES	-11%	-21%
BELLWAY	-8%	-21%
BERKELEY	-10%	-21%
COUNTRYSIDE PROPERTIES	-8%	-19%

Source: Shares, SharePad, Data as at 20 Nov 2018

UK house prices: monthly asking price trend

Source: Rightmove

Markets nervy as tech tanks and Brexit bites

Investors endure considerable volatility in both the US and UK

Uncertainty and volatility appear to be prevailing on both sides of the Atlantic with any hope of a so-called 'Santa Rally' in stocks looking unlikely at present.

The 19 November session saw renewed heavy selling on the US markets in big technology stocks after consumer electronics giant Apple cut production on three of its latest iPhone models amid reports of weaker than expected demand.

This news added to concerns that Apple and peers like Google-owner Alphabet, Amazon and Netflix may struggle to chalk up the levels of future growth required to underpin their lofty valuations.

It is worth noting that fears of over-saturation in the smartphone market are not new and Apple already trades on a significantly lower multiple of earnings than all of the other FAANG stocks.

But this grouping is now down some 20% from its 52-week peak level – putting it in bear market territory.

The US tech sell-off represented a second bout of significant market volatility in a matter of days after UK Prime Minister Theresa May announced a draft Brexit deal (14 Nov) but was then beset by cabinet resignations.

There is considerable scepticism over May's ability to get any deal through parliament and reports of threats to the agreement from France over fishing rights and, in particular, Spain over the status of Gibraltar are an added headache.

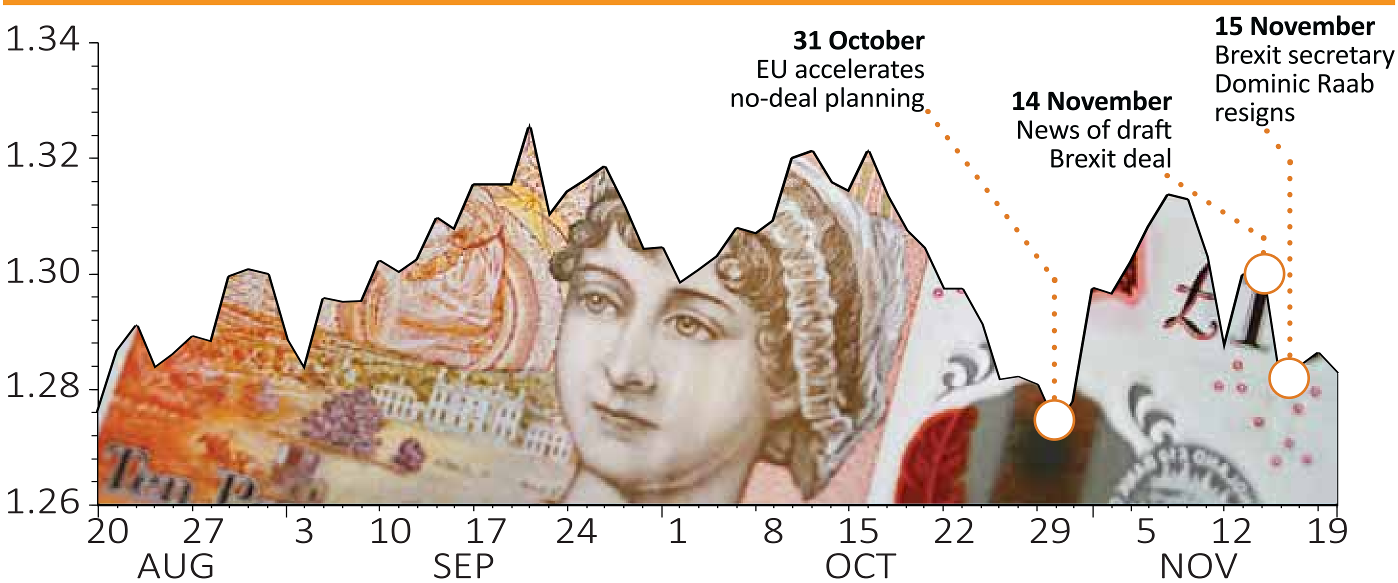
It is little wonder that domestic-facing companies are struggling on the stock market, with the likes of housebuilders, wider real estate businesses and banks all heavily sold off.

Sterling is current holding steady at around $1.285 against the dollar, having traded close to $1.27 in the wake of the resignation of Brexit secretary Dominic Raab on 15 November.

The currency is likely to remain sensitive to the continued machinations over May's position with a special EU summit looming on 25 November.

Assuming this meeting results in the deal being finalised and formalised from an EU perspective, May faces the nerve-shredding prospect of putting the agreement to a vote of MPs in mid-December. (TS)

POUND VERSUS US DOLLAR



Private equity investment trust giant 3i plays the waiting game

The FTSE 100 constituent is cautious about making new investments despite having a big cash pile

The UK's largest private equity investment trust **3i (III)** appears to be in rude health if you look past the sentiment-driven volatility in its share price.

Indeed, while the shares were caught up in the Brexit-related sell-off of UK assets, first half numbers (15 Nov) revealed a robust total return of 10%.

This is an enviable level, particularly when compared with the performance of stocks during the period in question. It is worth noting that further value in the portfolio is expected to be realised in the second half of its financial year.

The company hopes to deliver a mid-to-high-teens return for shareholders through the cycle.

'While 3i's stock price may be volatile over the coming months, we feel it retains a healthy and relatively cautiously valued portfolio, and one where management oversight remains high,' says Numis analyst Bill Barnard.

At 810p, the trust now trades on a 4.5% premium to net asset value, having traded more typically at a premium in the high teens and upwards historically.

The company made two new investments in the first-half period, buying into personal care products manufacturer Royal Sanders and cruise operator International Cruise and Excursions for a combined £247m.

3i has been adapting to structural changes across different industries, selling out of lingerie brand Agent Provocateur and fashion brand Hobbs in 2017 amid the pressure on the high street.

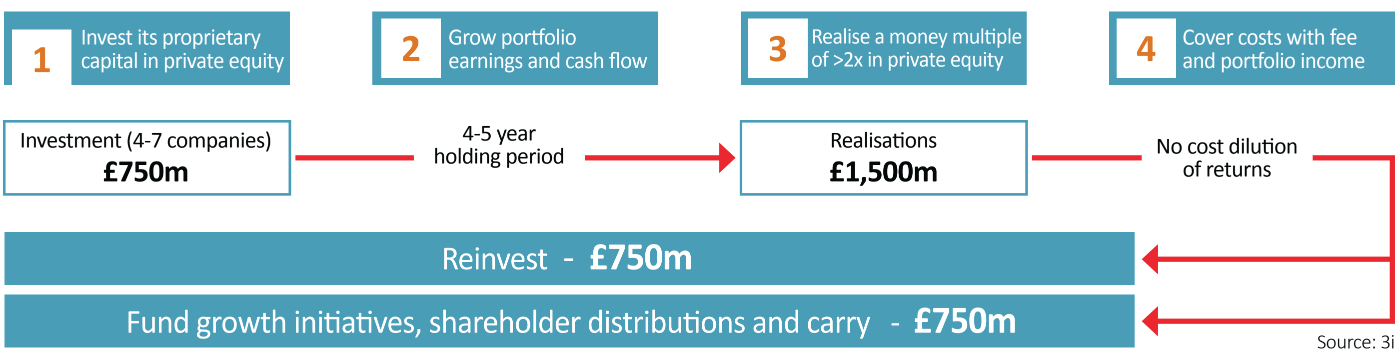
That said, European discount retailer Action remains by far its largest investment, and the company added to its position in the business in the period as it continued to deliver robust like-for-like growth.

Despite sitting on net cash of £512m, the company does not appear inclined to consider too many new investments at this point.

Chief executive Simon Burrows says: 'We have good momentum across our portfolio, but remain cautious about the pricing of new investment in general.'

Reading between the lines it looks like the company might be awaiting an opportunity to acquire assets more cheaply once the current market uncertainty has left its full mark on valuations. (TS)

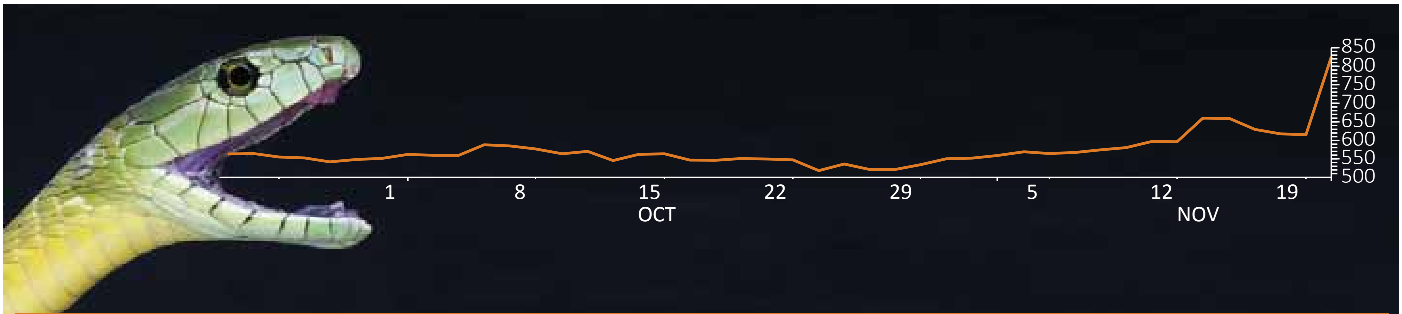
3I'S BUSINESS MODEL



Source: 3i

BTG, Smiths, AstraZeneca and more news over the past week

We look at the key announcements and how investors reacted to the news



SHARES IN SNAKE ANTIVENOM EXPERT BTG SOARED ON A £3.3BN TAKEOVER BID

Shares in FTSE 250 global healthcare business **BTG (BTG)** have soared by 34% to 823.2p after receiving a £3.3bn takeover offer from US rival Boston Scientific. The suitor is interested in BTG's interventional medicine platform, pharmaceutical and licensing businesses.

Engineering conglomerate **Smiths (SMIN)** has finally decided to separate its medical division after years of toying with the idea. The medical unit is struggling and has never really sat comfortably alongside Smiths' other divisions, which supply airport scanners and components and equipment to the energy and construction' industries.

Details on the shape of the Smiths seperation will not be decided until next year. The share price rallied nearly 9% to £14.30 on the announcement. Smiths previously held talks over the sale of its medical business, most recently walking away from negotiations with Nasdaq-listed ICU Medical.

Pharmaceutical giant **AstraZeneca (AZN)** has had a minor setback with lung cancer trials, although the share price reaction was minimal as expectations were low following a previous trial setback in July 2017.

Shares in **British American Tobacco (BATS)** have been burned by the US Food & Drugs Administration (FDA) submitting a proposal to ban menthol cigarettes, extending earlier share price losses amid speculation about the announcement. The FTSE 100 constituent generates circa 20% to 25% of its profit from the US menthol category.

After all the hype around its initial public offering (IPO) in October, **Aston Martin Lagonda (AML)** is finding it hard to win over investors. Its third quarter trading showed a jump in revenue as vehicle sales almost doubled, yet the stock fell nearly 10% on the day.

Peppa Pig majority brand owner **Entertainment One (ETO)** has taken a £57m hit amid the ongoing demise of DVDs. The value of some of its warehouse inventory has been reduced, and some of its library assets are now worthless. But this is a small issue in the bigger scheme of its business with adjusted pre-tax up 7% to £42m in the six months to 30 September 2018.

Consumer and business communications provider **KCOM (KCOM)** has issued another profit warning and slashed its dividend in half, prompting a near-40% decline in its share price to 57p. Earnings before interest, tax, depreciation and amortisation (EBITDA) is now expected to be circa 5% below expectations for the year to March 2019. Previous forecasts had already factored in an 8% decline year-on-year. (DC/SF/LMJ/JC)

Why Codemasters can get back in the fast lane

Driving games specialist is shifting gears with a boost from digital delivery

Following recent share price weakness, games developer and publisher **Codemasters (CDM:AIM)** has recovered to 183p, and we think it can maintain this renewed momentum. Notably investment bank Liberum has a 310p price target.

A play on the booming gaming industry, Codemasters' franchises boast huge fan bases and bags of future revenue upside.

The increased adoption of digital delivery is enhancing margins and the longevity of Codemaster's back catalogue and a strong Christmas period could turbo-charge current market forecasts.

CODEMASTERS BUY
(CDM:AIM) 182.5p
Stop loss: 130p

Market value: £256m

WHAT DOES CODEMASTERS DO?

Debuting on AIM in June, Codemasters has the exclusive licensing rights for the Formula 1 game franchise, while its balanced racing games portfolio also includes three own intellectual property franchises: DiRT, GRID and ONRUSH.

Half year results (13 Nov) revealed a 20% decline in revenue to £39.7m. This looks disappointing but three games were released in the prior year period versus just two major game releases in the reported period.

Codemasters will benefit from two further launches in the second half, F1 Mobile Racing and DiRT Rally 2.0, whereas there were no new launches released in the comparative period.

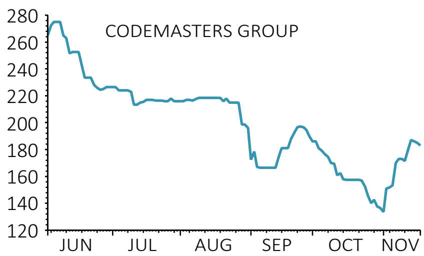
Gross margin improved to 88.5% (2018: 83.6%), benefiting from the ongoing shift to digitally downloaded games, which increases the longevity of the back catalogue and the predictability of revenue. Digital channels enable Codemasters to generate additional revenue by offering new content for existing games.

DiRT Rally 2.0 launches next February and the early press reception has been highly positive. F1 2018 launched in August and is the highest rated PS4 racing game of the year; F1 2018 is also at the centre of the F1 ESports series broadcast live on Sky TV and Facebook, which is bringing a new audience to the franchise. The potential loss of the F1 licence is one key risk to consider, albeit this is not something actively on the agenda.

GAME-CHANGING TIE-UP

In what could prove a game-changer, Codemasters has entered into a strategic revenue sharing partnership with Chinese internet tech company NetEase, which will be the exclusive publisher for three of Codemasters' upcoming PC titles within China. Not only will it obtain the necessary Chinese regulatory approvals, NetEase will also invest in marketing and localising the games to accelerate their growth in the world's biggest gaming market.

Codemasters is growing organically, but will also consider acquisitions and has £16.7m of net cash. All debt was repaid as part of the IPO. Liberum forecasts a rapid accelerate in profit in the coming years. (JC)



HOW CODEMASTERS IS DRIVING GROWTH

Year to March	2018 (A)	2019 (E)	2020 (E)	2021 (E)
SALES (£m)	63.6	71.5	81	90.2
Adj PBT (£m)	2.5	12.4	16.9	20.7
EPS (p)	8	11	12	14

Source: Liberum

A Warren Buffett-styled way to play emerging markets

Fidelity Asian Values has proven wealth creation credentials

It is a fairly bold call to suggest buying an emerging markets fund right now but we believe there are good reasons to back **Fidelity Asian Values (FAS)**.

The investment trust is built very much along Warren Buffett lines – manager Nitin Bajaj is a confirmed fan of the *Sage of Omaha*, and does his best to cast a similar investment critique over the portfolio.

Bajaj took over the trust in April 2015 with a remit to create long-term capital value by investing in high quality, yet mispriced stocks anywhere east of Istanbul, outside of Japan.

His preference is smaller and medium-sized companies that tend to get overlooked by most investors so it's where an edge can be gained and bargains snapped up.

Typical targets have relatively low debt and diversified revenue streams capable of putting up 50%-plus investment returns on a three year horizon. It is a crowded space with an estimated 15,000-odd companies to choose from, which suggests opportunities will not be in short supply come rain or shine.

The trust has no magic investment formula and tends to look beyond geopolitical and macroeconomic data in favour of investment analysis heavy lifting by putting more analysts on the ground than anyone else.

FIDELITY ASIAN VALUES ↗ BUY
(FAS) 404p
Stop loss: 323p

Market cap: £280m

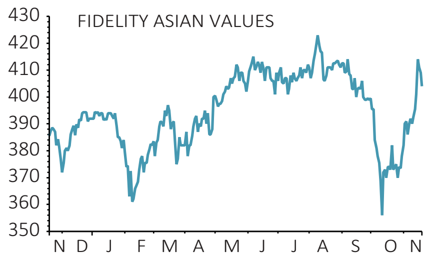
Fidelity Asian Values has adapted its portfolio as risk has escalated in emerging markets. This means holding bigger names, which have held up better in recent months. A good example is Bajaj's decision to take a stake in China Mobile, where 2.47% of the trust's funds now sit.

India is also a popular target, where US/China trade bickering has limited impact and internal investment has stayed firm. Examples include Power Grid Corp of India (its biggest stake), planes leasing company BOC Aviation, and Housing Development Finance Corporation, a major housing development project funder on the sub-continent.

The strategy has paid off in the past and should continue to do so, we believe.

Net asset value (NAV) has increased by more than 72% over five years, and the share price has beaten the Investment Trust Asia Pacific (ex-Japan) benchmark in each of the past one, three and five year periods, making the trust a top quartile performer.

The cost of that success is a 12-month average NAV discount of 2% evaporating and leaving the shares trading at a 4% premium. This, we believe, shows there is plenty of investor demand for emerging markets trusts able to demonstrate long-run success from simple and sensible investment principles. (SF)



AB DYNAMICS
(ABDP:AIM) £14.85

Gain to date: 58.4%

Original entry point:

Buy at 937.5p, 21 December 2017

FULL-YEAR RESULTS from **AB Dynamics (ABDP:AIM)** triggered a new share price rally and took the stock to an all-time high of £16.50. The stock has since eased back amid several directors selling shares.

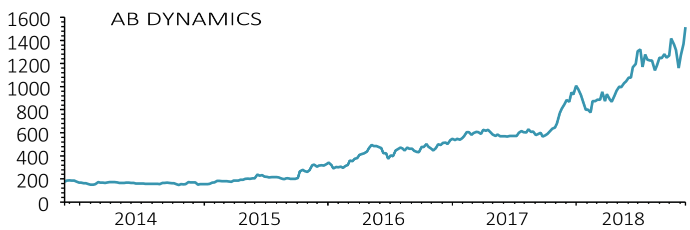
We aren't overly concerned by the director disposals as they have certain windows during the year to offload stock, due to strict trading rules, and it gives them an opportunity to crystalise some gains following a spectacular year for the business.

AB Dynamics grew adjusted pre-tax profit by 45% to £8.61m. Speaking to *Shares*, the company admits there is a risk it may receive more orders than it could fulfil, hence why it is now outsourcing certain activities to third parties.

It says investment plans will dilute operating margins, although it doesn't expect them to decline too much and for too long.

The company insists it is seeing no signs of car manufacturers reducing development spend, particularly as the traditional players are under pressure from new market entrants – namely tech firms.

New chief executive James Routh says his appointment provides an opportunity to refresh the corporate strategy and he will look at plans for research and development, acquisitions and more over the next few months.



SHARES SAYS: ↗

AB Dynamics is one of our top stock picks for 2018 and has delivered superb returns for shareholders. We still believe there is a lot more to come, so keep buying. (DC)

EI GROUP
(EIG) 173.8p

Gain to date: 1.6%

Original entry point:

Buy at 171p, 8 November 2018

WE REMAIN CONFIDENT UK pub company **EI Group (EIG)** has more to offer following an encouraging set of full year results (20 Nov).

In a bullish announcement, EI says its strategic plan to revive its prospects after struggling with huge amounts of debt during the financial crisis is complete, citing 'business as usual'.

EI is benefiting from its wet-led focus with like-for-like sales jumping 7.1% in its managed pubs division, marking an impressive acceleration from 2.4% growth last year.

The company is also faring well elsewhere with annual rental income increasing from £23m to £29m in the Commercial Properties division, which may be sold. Analysts think it could be worth £300m or more.

The majority of EI's pubs fall under the Publican Partnerships division, which generated a 1.2% rise in like-for-like net income, down from 2.3% a year earlier despite growth across all regions.

Liberum analyst Anna Barnfather is encouraged by EI's trading, flagging strong cash flow and another share buyback programme, while rapid deleveraging remains a realistic near term prospect.

SHARES SAYS: ↗

Keep buying. (LMJ)

FOCUSRITE
(TUNE:AIM) 427.5p

Gain to date: 32%
Original entry point: 324p, 27 Nov 2017

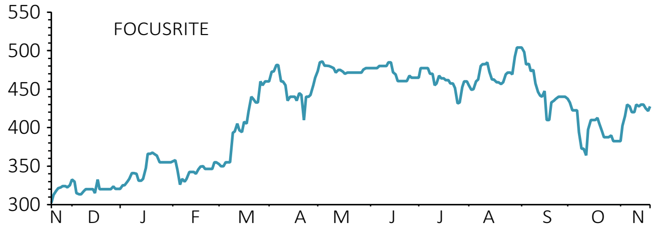
GLOBAL MUSIC and audio products innovator **Focusrite (TUNE:AIM)** has generated a 32% gain on our *Great Idea.* We're as excited as ever about its growth prospects following better-than-expected full year results (20 Nov).

Sales grew 13.7% to £75.1m in the year to August as Focusrite experienced growth in all major geographic regions and in both the Focusrite and Novation ranges, while also demonstrating an impressive expansion of gross margin.

Cash-generative Focusrite is also increasing the dividend by 22% to 3.3p and with year-end net cash of £22.8m, has the funds to invest in a growing new product pipeline and scout for earning-accretive acquisitions.

Panmure Gordon analyst Andrew Blain has a 500p price target for Focusrite, forecasting growth in pre-tax profit from £14.5m to £15.3m this year.

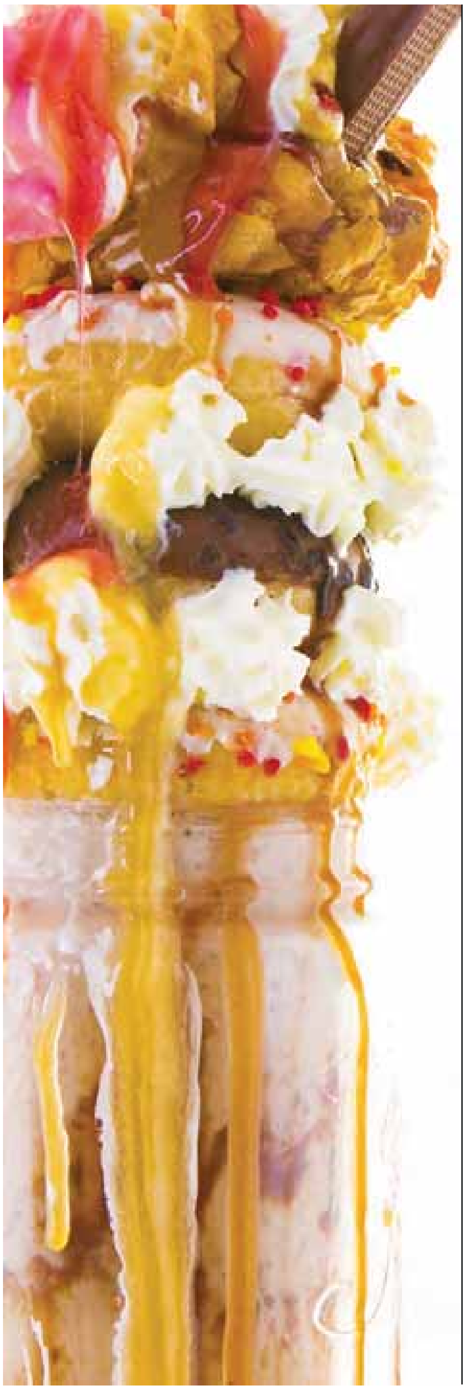
'Solid trading momentum and a raft of initiatives to further drive the performance means Focusrite stands out as a rare UK consumer business confident in its outlook for the year ahead', he says.



SHARES SAYS: ↗
With Focusrite continuing to make all the right noises, we're sticking with our positive view on the stock. (JC)

Should investors look at ways to play the fight against obesity?

We look at how the market is developing and the sectors that could prosper or struggle



A recent demand from campaign group Action on Sugar to ban milkshakes with chocolate, sweets, cake, cream and sauce known as freakshakes, has reignited the debate on how to tackle the obesity epidemic.

With some freakshakes containing over 1,000 calories, campaigners are right to be concerned, but what do rising obesity rates mean for investors?

Berenberg analyst Asad Farid argues the diabetes epidemic is being underestimated by investors, claiming the International Diabetes Federation's (IDF) forecasts are not high enough.

For example, IDF projections of 380m diabetes patients by 2025 were achieved 10 years earlier than expected.

Overweight people are more likely to develop diabetes with the data implying more people will become overweight and develop the condition, placing more strain on tight healthcare budgets.

The cost of diabetes treatments is staggering with global healthcare expenditure of $627bn reaching levels 20 years ahead of IDF's previous forecasts, marking a huge disconnect between expectations and reality.

On average, 10% to 15% of total healthcare expenditure is being spent on treating and managing diabetes according to Farid.

While the diabetes epidemic is worrying, there are many ways to prevent people becoming diabetic.

WHAT IS THE READ-ACROSS TO THE STOCK MARKET?

There are numerous stocks which are relevant to this theme although any references in this article are purely to flag relevant names rather than us presenting investment ideas.

You would need to do your own research on each stock and consider aspects like valuation, market position and financial strength rather than simply picking them because they play into a certain theme.

Keeping active is one of the best ways to avoid becoming diabetic and generally improve overall wellbeing, although time and cost can act as a deterrent.

The UK's second-largest budget gym operator **The Gym Group (GYM)** is expected to continue opening new sites despite intense competition. Its shares have risen by 55% in the past 12 months.

'Physical inactivity in the adult population has been on the rise globally, with North America being the only region where activity levels have improved. We expect that governments globally will strive to increase physical activity, which will drive the penetration rates of gyms,' says Farid.

He believes there will be greater tax incentives on gym membership in the US and Europe. It sees continued growth in affordable budget gyms and boutique clubs, specialising in one to two health activities such as yoga and cycling. He also predicts an increasing number of health insurers and employers subsidising gym membership to reduce healthcare costs.

An alternative to working up a sweat is to cut down on high sugar content that lurks in everyday products such as yogurts and pasta sauce, as well as sweets and chocolate.

The UK Government recently imposed a sugar tax, forcing companies to pay tax if their products exceed a specified amount of sugar. That is expected to encourage companies to seek healthier alternatives.

Examples of London-listed companies relevant to this theme include **PureCircle (PURE)** which produces stevia sweeteners for a range of products, including soft drinks, breakfast cereals and sauces. Stevia is a naturally-sourced sugar substitute which has no calories.

There is also **Kerry Group (KYGA)** which manufactures ingredients and solutions for the food and beverage sectors. 'It could help companies create new products and reformulate old ones with less sugar and using natural ingredients,' says Farid.

THE HEALTHCARE ANGLE

In the healthcare space, companies developing glucose monitoring systems may prosper by enabling people to monitor their glucose levels and avoid dangerous complications from diabetes. The Berenberg analyst argues that companies with a diabetes treatment will not necessarily succeed, flagging that sales of basal insulin and generic products may struggle against more innovative products.

Other issues to consider include the risk of broadcasting companies losing out on advertising income if restrictions on advertising unhealthy food are tightened. For example, fried chicken chain KFC and breakfast cereal colossus Kellogg's both recently fell afoul of advertising rules for high fat, sugar or salt products and were told to remove adverts by the UK watchdog.

The topic of obesity is central to a US-listed exchange-traded fund called Janus Obesity ETF. It tracks the performance of the Solactive Obesity Index which contains a basket of stocks that play into this theme. Holdings include pharmaceutical group Novo Nordisk, medical implant devices manufacturer Abiomed, kidney healthcare specialist DaVita and weight loss expert Weight Watchers.

Janus Obesity ETF has risen by 38% in share price terms over the past year versus just under a 10% gain from its benchmark, the MSCI All-Country World index. (LMJ/DC)

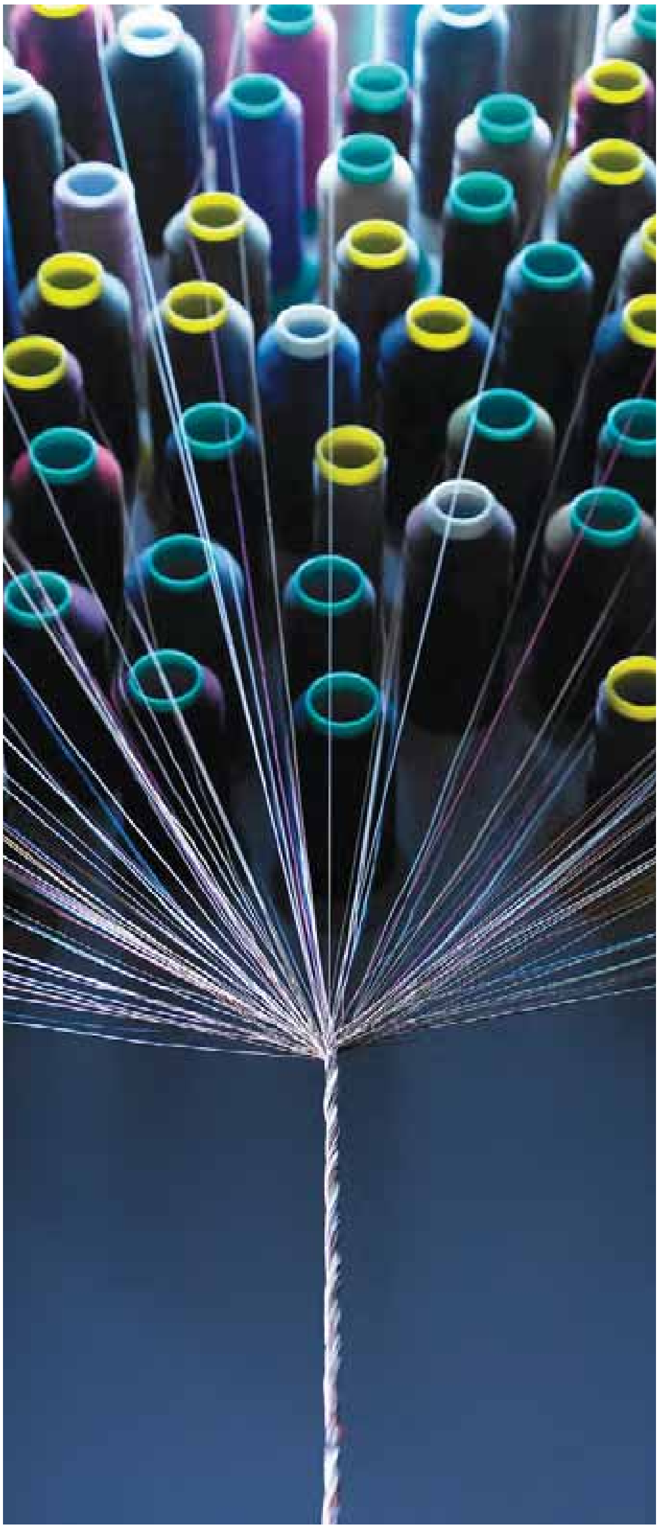
BEER: It is feasible to predict calorie labelling of beers in the future, which could potentially trigger a shift in consumer appetite towards lower-calorie products.

SOFT DRINKS: Consumption is falling and sugar taxes are being rolled out in various parts of the world.

BLACKROCK®

NAVIGATING THE SMALL-CAP UNIVERSE VIA AN INVESTMENT TRUST

Roland Arnold
Portfolio Manager,
BlackRock Smaller Companies Trust plc



Investing in smaller companies offers the potential for growth and income. Portfolio manager Roland Arnold explains how investors can make the most from this vast selection of stocks

Capital at risk: All financial investments involve an element of risk. Therefore, the value of your investment and any income from it will vary and your initial investment amount cannot be guaranteed. Smaller company investments are often associated with greater investment risk than those of larger company shares.

The UK smaller companies sector is home to some of the most exciting businesses listed on the London market. These companies offer a long runway of growth potential as they develop new products or markets or are bought out and fundamentally shift their operations to capitalise on market opportunities.

The small-cap sector has consistently demonstrated greater earnings growth than its larger peers (FTSE, 2018), which has in turn manifested itself in greater long-term returns for shareholders. The small-cap story is particularly attractive in the UK, where investors may benefit from legal protections and accounting and listing standards greater than those available in many other equity markets globally.

None of this is in dispute, so how best can investors gain exposure to the opportunities available in UK small and medium-sized companies?

There is no guarantee that any forecasts made will come to pass.

Going it alone?

Direct investment sounds simple, but to find genuine opportunities individuals would need to conduct fundamental research into each of the companies in the investable universe, which is no easy task if you consider that there are over 1,200 companies in our benchmark. They would need to understand the potential each stock presents and build a portfolio of the best opportunities. This takes time and given that the smaller companies sector is an under-researched part of the market, getting adequate information is difficult. Then there is the cost of building a portfolio of well-diversified stocks, which is important if investors are to avoid exposure to individual company risk.

Essentially, it is difficult for individuals to invest in smaller companies and achieve appropriate diversification and adequate risk management.

BlackRock®

Strength in numbers

An alternative to going it alone is to outsource the research and portfolio construction by investing in a fund which can also spread the cost.

Investing in a closed-end fund – or investment trust – in this way may have several possible benefits. An investment trust is a registered company and issues a fixed number of shares to investors. This means the portfolio managers do not have to worry about sudden inflows – or outflows – of money. It also means the manager can invest confidently in companies that might be harder to sell quickly – known as illiquid investments – which is vital with smaller companies since it can take time to get returns. Being closed-ended may also limit the potential challenges if the fund suddenly becomes flavour of the month since it cannot accept a sudden influx of investment. This can be an advantage over open-ended funds because they must invest new inflows even when the manager may find it difficult to identify suitable investment opportunities.

BlackRock has not considered the suitability of this type of investment against your individual needs and risk tolerance. We recommend you seek independent professional advice prior to investing.

This structure also means that the trust does not need to hold a cash buffer to pay exiting investors. Instead, shareholders who want to exit can sell their shares to other investors through the secondary market. This means clients' investments are always fully exposed to the market.

It's a company

Investment trusts can also borrow. This means managers can invest even more in smaller companies on behalf of investors. Different trusts will adopt different levels of borrowing (usually referred to as 'gearing'), and they can borrow more or less in the face of different market conditions. Clearly this can work against investors in falling markets, so understanding how different trusts borrow is key before committing any money. The current gearing level of the BlackRock Smaller Companies Investment Trust plc is 8% (as at 31 July 2018), and we traditionally operate in a 7% to 10% range.

Investment trusts also have a greater degree of flexibility over the size and frequency of dividend distributions when compared to open-ended funds. An open-ended fund has no choice over distributions and has to pay out all dividends received. An investment trust can retain up to 15% of revenues earned in each financial year which means that trusts can build up revenue reserves over time so, even in difficult markets, they can still make a smooth schedule of payments. The BlackRock Smaller Companies Trust has increased its dividend every year of the past 15 years and most recently grew the dividend by more than 23% in the year ending 28 February 2018.

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Additional safeguards

Importantly, investment trusts also provide investors with an additional layer of governance. Independent boards act on behalf of investors, ensuring the fund manager is adhering to the investment philosophy of the fund and, if necessary, the board can appoint a new manager if they are unhappy with performance.

Finally, the share price of an investment trust on the open market can often trade at a premium or a discount to the value of its assets. For instance, the BlackRock Smaller Companies Trust currently trades at a 8.5% discount (as at 31 August 2018)[1], allowing you to buy £1 for 92p, and who doesn't like that?

For more information on this Trust, the risks involved and how to access the potential opportunities presented by smaller companies, please visit **www.blackrock.com/uk/brsc**

Trust specific risks

The Trust's investments may have low liquidity which often causes the value of these investments to be less predictable. In extreme cases, the Trust may not be able to realise the investment at the latest market price or at a price considered fair. Investment strategies, such as borrowing, used by the Trust can result in even larger losses suffered when the value of the underlying investments fall.

Important information

BlackRock have not considered the suitability of this investment against your individual needs and risk tolerance. To ensure you understand whether our products are suitable, please read the Key Investor Documents (KIDs) and the Annual and Half Yearly Reports available at blackrock.co.uk/its which detail more information about the risk profiles of the investments. We recommend you seek independent professional advice prior to investing.

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[1]www.lse.co.uk/regulatory-news-article.asp?ArticleCode=d3sgxklx&ArticleHeadline=Portfolio_Update

7 UNLOVED STOCKS: CAN THEY BOUNCE BACK?

We examine why they are getting the cold shoulder and how this is relevant to researching other investments

It is important to take a balanced view when doing your research either for new investment ideas or to justify keeping current holdings in your portfolio.

You should consider the positive investment case and also the challenges and headwinds facing a business, as well as any flaws in its decision making, structure or corporate culture, for example.

Many investors find it easier to work out why a company could be attractive by only looking at its growth potential. Less attention is given to the potential nasty factors that could prevent an investment from generating a positive return.

A more balanced view can sometimes be obtained by considering why other investors are negative on certain companies. You can do this by looking at the list of most shorted stocks which is published on a daily basis by the FCA, a financial regulator.

Short selling means borrowing a slug of stock from a shareholder with the goal of buying the stock back (to close the trade) at a much lower price. The goal is to profit from a fall in the share price.

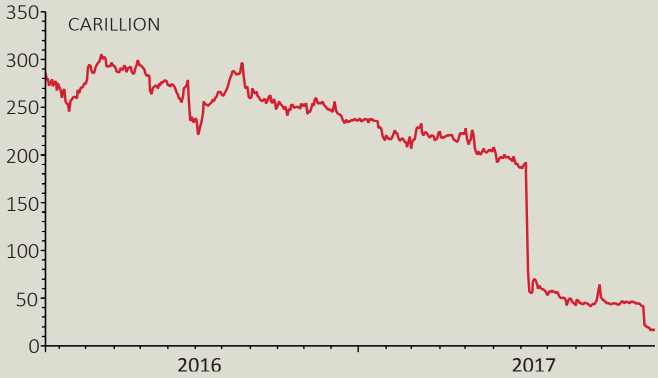
This activity is inappropriate for the vast majority of investors. If you buy shares in a company the worst you can endure is a 100% loss if the company goes bust and your stock ends up being worthless. In contrast, you can lose a lot more money with shorting, far beyond the cost of your initial trade.

Shorting is incredibly high-risk and this article is certainly not encouraging you to try it out. Instead, we believe you should just look at why short-sellers are attracted to certain stocks to get you in the practice of forming more rounded views with investments and not simply looking at the upside potential.

Later on in this article we will look at the seven most unloved stocks, being the most shorted ones on the London market, and look at reasons why they could fall further or bounce back. This exercise is to primarily stimulate your thought process rather than us fishing for recovery plays.

SHORTERS WERE RIGHT WITH CARILLION

Construction services business Carillion is a prime example of where short sellers got it right. Its shares were among the most shorted on the UK stock market for about four years.



The company's share price was falling for a long time before it eventually went bust in January 2018.

Among the reasons why it failed were taking on riskier contracts where it was hard to make a profit, payment delays from clients in the Middle East, and running up an enormous debt pile under which it eventually buckled.

Savvy shareholders who noticed the large amount of short positions on the stock may have become less willing to own Carillion and potentially got out before major damage was done. Sadly many other investors were blind to the problems and ultimately lost everything.

TOP 20 UK SHORTED STOCKS

Company	% of stock short	Number of funds short
Kier	12.7%	11
Pets at Home	12.6%	8
Ultra Electronics	11.9%	10
Arrow Global	11.5%	10
Marks & Spencer	11.4%	10
Debenhams	11.1%	5
IQE	10.6%	9
Plus 500	9.9%	9
Travis Perkins	9.2%	10
Anglo American	9.0%	7

Company	% of stock short	Number of funds short
Pearson	8.1%	7
Metro Bank	7.0%	8
Telit Communications	6.8%	4
Restaurant Group	6.7%	6
AA	6.6%	3
Wood Group	6.5%	6
Babcock	6.4%	6
GW Pharmaceuticals	6.2%	5
Interserve	6.0%	5
Sirius Minerals	6.0%	6

Source: Castellain Capital, FCA

SHORT END OF THE STICK

Short-sellers are often viewed negatively. They can be perceived as greedy and opportunistic, if not downright manipulative, putting a bet on shares they do not own with the aim of driving down a particular share price.

Some investors take the emergence of short positions in one of their own portfolio holdings as a personal attack.

What is usually forgotten amid the emotion is the real value that short-sellers can bring. For decades short-sellers have done the hard digging required to expose corporate fraud, for example.

When analysts, fund managers and a company's own auditor fail to identify serious problems in a business, sometimes the short-sellers can.

In some cases, the FCA or the Serious Fraud Office are only alerted to potential rule breaking after it has been exposed by a short-seller.

It was a short-seller that sniffed out the financial issues at Enron in 2001. Closer to home, it was damning analysis that led to the downfalls of AIM stocks Quindell and Globo, having taken in a host of usually savvy investors and analysts.

A generous interpretation might characterise short-sellers as the stock market's detectives. That said, one must also recognise the potential for individuals to spread lies in order to drive down a share price for their own financial gain.

There are examples where short-sellers engage in market manipulation to achieve their returns, most notably with so-called 'bear raids'.

Bear raiders have a functional modus operandi that involves shorting a share, then publishing allegations of wrong doing or simple ineptness in the hope of sparking panic. This usually involves researching a company's finances well enough to discover a financial weak point or outright malpractice.

But sometimes these charges are unfair, and the bear raider is just preying on the insecurity of investors and relying on a herd-like reaction from the market.

WHO ARE THE CURRENT TARGETS?

Defence engineer **Babcock (BAB)** and analytics software business **First Derivatives (FDP:AIM)** are both examples of UK companies recently being targeted by these types of aggressive short-sellers.

Compound semiconductor wafer designer **IQE (IQE:AIM)** has also been targeted in the past (more about IQE later).

Today, the building industry remains in the sights of short-sellers with some investors betting heavily against contractor **Kier (KIE)**. Others perceive a bleak Christmas for some hard-up retailers.

GETTING TO THE BOTTOM OF THE STORY

There are lots of reasons why some investors are willing to bet against a company's share price. These range from simply believing that a current valuation is too frothy and unsustainable to a belief that corporate incompetence will get found out in time. Or, in the worst cases, that outright fraud might be uncovered.

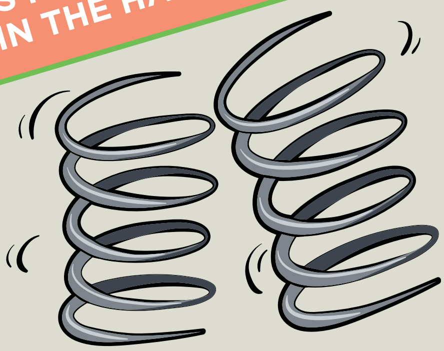
Understanding why a company has fallen under the sceptical gaze of short-sellers is a useful exercise for all investors.

Some of the companies are popular short-seller targets for obvious reasons such as the story of struggling sales and hefty store rents at **Debenhams (DEB)**.

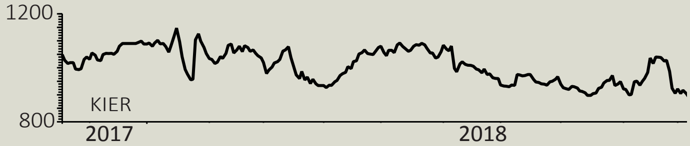
For other short-selling targets, the rationale may be harder to put your finger on. *Shares* has done the digging and we try to explain in simple language the lure for the bears in seven cases, plus reasons why some people may still see opportunities for the shares to bounce back.

It is important to remember that short-sellers don't always get it right and every DIY investor has the responsibility of doing their own research at all times.

MORE THAN £100M OF KIER (UK'S MOST SHORTED STOCK) IS IN THE HANDS OF BEARS



Kier (KIE) 861.5p



Proportion of stock on loan to short-sellers: 12.7%

THE BEAR CASE

Construction and infrastructure outfit Kier has been a target for short-sellers because of its high debt levels and exposure to an industry beset by contract delays and cost overruns.

Average monthly net debt is guided to fall marginally in its current financial year but at £390m is probably too high for comfort.

The fate of its counterpart Carillion earlier this year, which also was heavily shorted before it went bust, is also a big factor behind why so many people dislike Kier.

Among the issues at Carillion was the use of supply chain finance, whereby suppliers sell their invoices to a bank at a discount and effectively get paid immediately. The bank then collects from the payer (Carillion) later on.

This boosts working capital for both parties in the short-term but arguably obscures the true state of the payer's balance sheet. Notably Kier also uses this financing option.

THE BULL CASE

The company is looking to improve its balance sheet and the recent disposal of its Australian highways business provides a useful £24m cash injection.

Kier does generate fairly robust cash flow and management incentives are now tied to average monthly net debt (as opposed to a year-end figure which could be massaged).

The firm tends to avoid the type of big unwieldy contracts which contributed to Carillion's woes.

CHANCES OF SHARE PRICE RECOVERY OVER THE NEXT 12 MONTHS: MEDIUM

A June 2019 price-to-earnings ratio of 7.2 and a dividend yield of 7.7% suggests a lot of bad news is priced in. Yet management have little margin for error and a recent trading update (16 Nov) guiding for a second half weighting to the current year could be a precursor to a profit warning unless the trading period is executed flawlessly. (TS)

Pets at Home (PETS) 114p

Proportion of stock on loan to short-sellers: 12.6%

THE BEAR CASE

Short-sellers' paws are all over pet food-to-veterinary services specialist Pets at Home amid competitive threats from online players and discount supermarkets, and the substantial lease commitments on the retailer's balance sheet.

A number of management changes since Pets at Home's 2014 stock market debut haven't helped to foster positive sentiment either.

The need for keen prices to stay competitive is margin dilutive, and what's more, Pets at Home's joint venture vet practices aren't expected to be profitable for a number of years and a shortage of veterinary practitioners is pushing up vet salaries.

Pets at Home is having to support maturing vet practices with working capital loans, which is suppressing free cash flow.

THE BULL CASE

Bulls argue the pet supplies-to-grooming salons operator offers a recovery play in a structural growth market because pet care spending is reasonably defensive.

They also point to Pets at Home's retail business, which has shown a promising recovery in like-for-like sales, with the business becoming more competitive on pricing and a new offer of easy-repeat delivery across an array of online products.

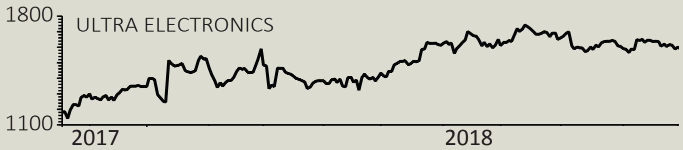
A positive first quarter trading update (3 Aug) revealed a welcome acceleration in group like-for-like revenue growth, reflecting progress in the retail business and a like-for-like sales leap in the vets arm.

CHANCES OF SHARE PRICE RECOVERY OVER THE NEXT 12 MONTHS: MEDIUM

At 114p, shares in Pets at Home are trading on 8.3 times forecast 2019 earnings, a rating which discounts the challenges ahead yet fails to factor in Pets' many strengths. While there is re-rating potential, we would wait for further evidence of a turnaround before considering an investment. (JC)

Ultra Electronics (ULE) £14.68

Proportion of stock on loan to short-sellers: 11.9%



THE BEAR CASE

The FTSE 250 electronics and software supplier is active in many industries including energy, security, transport and aerospace. It it is best known as a defence contractor to the Ministry of Defence and other national agencies.

Bears believe having so many small moving parts means that Ultra is losing focus. A patchy financial track record over recent years suggests there might be something in those claims.

Since 2013 revenue and profit have fallen as often as they have clambered higher, while analysts at investment bank Berenberg note that Ultra has failed to deliver annual organic growth since 2011.

THE BULL CASE

The responsibility for getting Ultra back on a stable growth footing falls to new chief executive Simon Pryce, in the top job since June 2018. His remit is to create an effective corporate strategy for the future, which will include a long hard look at its portfolio of operations.

That suggests bits may be hived off and sold leaving a more concentrated business capable of implementing top operational performance and financial discipline that does what a mature business should do – throw off lots of cash.

Strong relationships with key defence organisations stands it in good stead. It's early days but if Pryce makes the right moves, he could potentially unlock very decent recovery potential from the shares.

CHANCES OF SHARE PRICE RECOVERY OVER THE NEXT 12 MONTHS: MEDIUM

The new CEO deserves the benefit of the doubt at this early stage, but investors would be wise to wait for firm signs that Pryce's plans are bearing fruit before considering an investment. (SF)

Arrow Global (ARW) 205p

Proportion of stock on loan to short-sellers: 11.5%

THE BEAR CASE

Debt purchaser Arrow Global has been widely criticised by investors for having accounts that can't be trusted due to the large gap between actual earnings and what the company calls 'underlying' earnings.

These exclude the cost of refinancing its significant debt, which is an intrinsic part of its business, and give a misleading picture of the risks and returns of owning the business.

THE BULL CASE

The bulls, which includes many analysts, argue that Arrow's business is low risk and high return with strong cash generation and potential for sizeable dividend payments in future years.

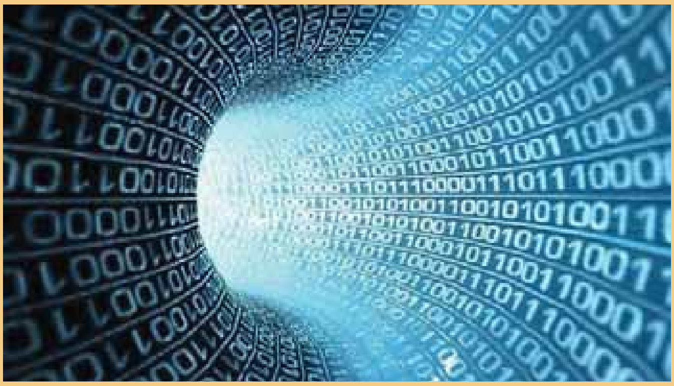
Its position in niche debt markets means it can continue to earn a premium return.

Meanwhile its asset management business provides growth and earnings stability.

CHANCES OF SHARE PRICE RECOVERY OVER THE NEXT 12 MONTHS: MEDIUM

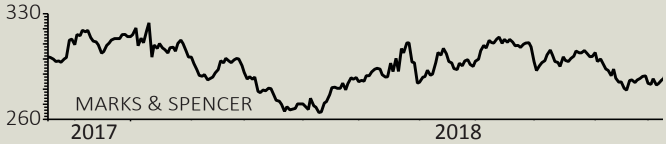
At 200p Arrow Global currently trades on just five times consensus 2019 earnings and offers a prospective dividend yield of over 7%, so there is no doubt that Arrow Global is optically cheap.

With the majority of analysts rating the shares a 'buy' and a consensus price target of 270p, you can see why this stock may interest investors with an appetite for higher risk, barring an issue with the accounts. (IC)



Marks & Spencer (MKS) 291.1p

Proportion of stock on loan to short-sellers: 11.4%



THE BEAR CASE

As well as being exposed to falling in-store sales as shoppers desert the high street, its online offering is sub-standard and requires significant investment according to the short-sellers.

Its food business, which accounts for more than 50% of revenue, is underperforming with like-for-like sales down 3% in the first half.

The bears argue that restructuring plans don't go far enough to get the company back onto a growth trajectory.

BULL CASE

Supporters of M&S point to the fact that the new management team has identified the problems and isn't sugar-coating them.

As well as reducing the store count there is a new focus on cutting costs and complexity from its supply chain.

Also, part of the reason for food sales stagnating is a deliberate move away from promotions. A similar strategy is already paying off in clothing where full-price sales are now rising.

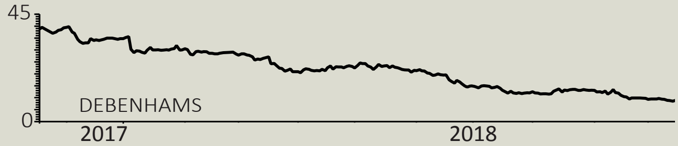
CHANCES OF A SHARE PRICE RECOVERY OVER THE NEXT 12 MONTHS: LOW

At 292p Marks & Spencer's shares currently trade on 14 times consensus 2019 earnings and a prospective dividend yield of 6.5% which is at the high end historically.

Analysts are forecasting a fall in sales and operating profit next year and then zero growth for both out to 2021. Unless the company can prove them wrong the shares are likely to stay unloved. (IC)

Debenhams (DEB) 6.17p

Proportion of stock on loan to short-sellers: 11.1%



THE BEAR CASE

A structural shift to online shopping in conjunction with weaker consumer demand has decimated the core business of Debenhams. It has coughed up a string of profit warnings and remains locked in a battle for survival with a department store model ill-equipped for the new age of retailing.

Encumbered by substantial long-term lease commitments, Debenhams posted (25 Oct) a record loss of almost £500m for the year to 1 September, the biggest deficit in its history as the consumer continues to shun bricks for clicks.

The company has written down the value of assets, scrapped the final dividend and pared back planned capital expenditure plans in order to conserve cash and reduce net debt.

Supporting the short-selling thesis are negative like-for-like sales amid weak fashion and beauty markets and discounts which are eroding Debenhams' margins. Reports of difficulties with suppliers ahead of Christmas are providing additional fodder for the bears.

THE BULL CASE

A turnaround strategy is in motion with new format stores delivering improved metrics and Debenhams' online business growing rapidly.

One could argue that so much bad news is already in the share price, so only something as extreme as a disastrous Christmas trading period or severe financial problems may sink them further.

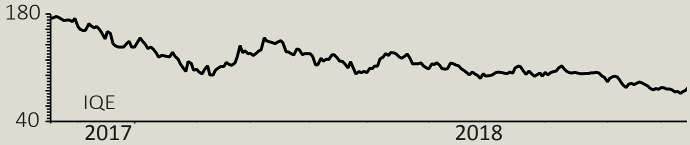
CHANCES OF SHARE PRICE RECOVERY OVER THE NEXT 12 MONTHS: LOW

At a bombed-out 6.17p, embattled Debenhams sells for a paltry three times the 2p of 2019 earnings forecast by Liberum Capital, a rating which suggests Debenhams is priced to go bust.

We've consistently been negative on Debenhams for many years and fear for the business given its long leases and the structural challenges in front of it. (JC)

IQE (IQE:AIM) 57.3p

Proportion of stock on loan to short-sellers: 10.6%



THE BEAR CASE

When a stock jumps tenfold in price in just 15 months its investment credentials were bound to be put under the microscope, and that is the case at IQE, a compound wafers designer for the semiconductors industry.

Sceptics argue that IQE is a very expensive minor player in a complex supply chain with limited control over pricing given the scale of some of its clients.

Apple is widely believed to be among its clients, a giant of the technology industry well-known for squeezing its supply partners. Recent volume order cuts have added to the bears' sense that IQE is still at the mercy of a smartphone industry at saturation point.

It is also fair to say that this science-heavy business is complex and misunderstood by many investors without the benefit of a PhD in physics. That leaves it open to scare mongering using terminology which can sound believable but can be aimed at causing panic among those less informed.

THE BULL CASE

Fans of IQE see the company at the very root of a technological shift away from silicon to more adaptable chemical formats, gallium arsenide (GaA) and gallium nitride (GaN), as bases for silicon microchips increasingly embedded into 'smart' everything.

Implied slowing Apple orders is a short-term knock, without doubt. But supporters will argue that new gizmos – such as the vertical-cavity light-emitting laser (VCSEL) technology used in facial recognition – is typically debuted in high end devices like Apple's iPhones, only to be rolled out in much greater volumes by the legion of Android-based smartphones in time.

Android smartphones count for about 85% to 90% of all smartphones sold worldwide.

Importantly, smartphones is just one of the possible growth markets to which IQE is adapting its technology in the hope of creating vast value for shareholders. 3D technology, data centre tools, 5G next generation mobile networks and infrared applications are some of the others.

CHANCES OF SHARE PRICE RECOVERY OVER THE NEXT 12 MONTHS: MEDIUM

Judging IQE on 12 or even 24 month forecasts can make the stock look expensive, although a 2019 PE of 13.6-times suggests upside potential if order growth stabilises.

The broader semiconductor industry is under pressure at the moment, meaning sentiment may remain poor towards IQE in the near-term. (SF)

Apple is widely believed to be among IQE's clients

441 FUND MANAGERS HOLD SHORT POSITIONS ON UK STOCKS, ACCORDING TO CASTELLAIN CAPITAL

EDISTON PROPERTY INVESTMENT COMPANY

EPIC FOR INCOME

If you're looking for monthly income, you want it to be built on firm foundations. At Ediston, we take that seriously – and literally. All of our investments are in properties we know inside out and from top to bottom.

This in-depth understanding of our investments assures us that the income we provide to our investors is as solid and secure as it can be. That's why we're able to pay a highly competitive dividend in monthly instalments – allowing our investors to rely on a steady income stream to cover everyday expenses.

A growing dividend

Ediston currently offers a 5.3%* annual yield. Our income payments stem from a diversified portfolio of properties, helping the sustainability of the overall dividend. We have maintained the dividend since the inception of the fund, and we expect it to grow in future. The dividend is also well covered – meaning there's something in reserve if underlying earnings fluctuate.

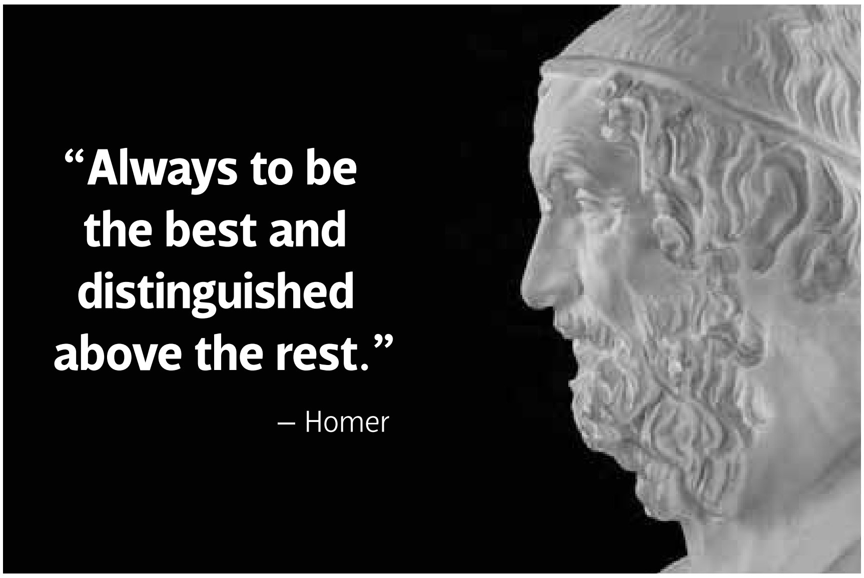
*as at 30th September 2018

A wealth of experience

The strongest support for our dividend comes from the expertise of our team. We live and breathe property. While the Ediston Property Investment Company listed on the London Stock Exchange (LSE: EPIC) in 2014, the broader Ediston business has been operating in the UK market since 2004. On average, each member of our team has more than 20 years' experience in property investment and development.

Beyond bricks and mortar

When we consider any investment, our focus is always on cash flow. We want to be sure that our properties are not just paying for themselves but also paying out sustainable income for our investors.



To do this, we look well beyond the physical buildings themselves to understand how the properties 'live and breathe' – how they fit into their location and their economic environment. We go to great lengths to ensure that risks to the cash flow are minimised and that occupancy rates and tenant satisfaction are maximised.

We have a profound understanding of all aspects of managing real estate for the benefit of our tenants and investors. This spans the range from change-of-use applications, through to refurbishment and redevelopment, to tenant liaison, lease negotiations and rent reviews. Each of these aspects offers opportunities for improving the income stream available from property.

ediston

Intensive, entrepreneurial and unconstrained

Our approach to property investment is intensive and entrepreneurial. No holding in our portfolio is left to look after itself. We sweat the small stuff, and we do it at every level of the process – from developing new properties to ensuring that existing tenants are satisfied and that no potential for improvement is missed. And with no benchmark, we're free to focus on the areas where we see the greatest potential for sustainable income and steady capital growth.

We're confident that our record of steady income and sustainable capital growth is a compelling combination. So, if you need a regular income stream from actively managed investments, we've got you (and your dividend) covered. ■

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Speedy Hire is fixed and ready for the next growth leg

Increased focus on smaller companies and services is paying off

Investors don't need particularly long memories to recall the dark days of 2015 when **Speedy Hire (SDY)** issued two profit warnings in quick succession due to falling sales and rising costs.

In the space of a couple of months the shares went crashing from 76p to 28p, a loss of nearly two thirds.

The company moved quickly to appoint Russell Down as its chief executive and thus began its lengthy recovery.

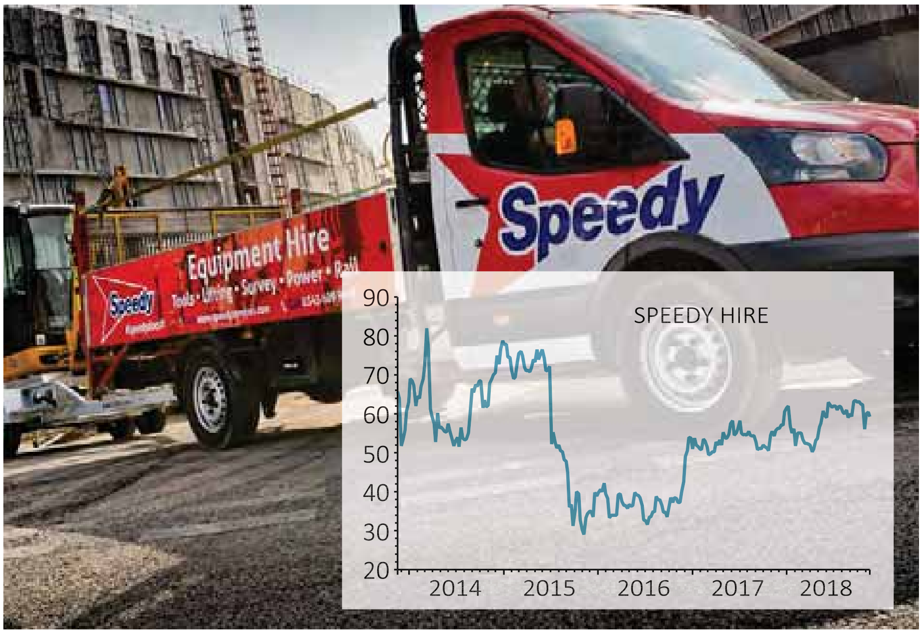
Today Speedy Hire is in rude health as the UK's leading tool, equipment and plant hire firm and now trades at 60.4p.

It operates via a network of over 200 local hire depots in the UK and Ireland as well as on-site facilities at client locations.

UK rental revenues are worth around £2bn a year as a sector but the market is highly fragmented. Speedy Hire has a 7% market share.

It has solid relationships with 85 of the top 100 contractors and while this was an advantage in the past the company is actively adding small and medium-sized customers, partly to reduce the risk of relying on big customers, as shown by the collapse earlier this year of Carillion.

Another reason for pushing into the small and medium sized market is that rental rates are higher. This means better margins and, as this is where the bulk of customers are, there is plenty of growth potential.



SMALLER CUSTOMER FOCUS IS PAYING OFF

Speedy Hire has spent time, effort and money finding out exactly what its customers want and then has set about delivering it.

The number one priority for clients wasn't price but availability, so Speedy Hire introduced a same-day service for orders received before 3pm.

It also used technology to analyse customer demand using its own records and then began a targeted sales and telemarketing campaign.

As the latest results show, this strategy is already paying off with group sales up 6% to £193m for the six months to 30 September 2018.

In fact revenue growth from small and medium-sized customers was more than enough to offset the loss of sales to the now-defunct Carillion.

Also the higher margins on renting to smaller customers helped lift pre-tax profit by 24% to £13.4m, ahead of analysts' forecasts.

This in turn allowed the company to increase its interim dividend from 0.5p to 0.6p per share, which may be a modest increase but is still a sign that the company has confidence in the future.

TECHNOLOGY DRIVING GROWTH AND MARGINS

As well as using software and artificial intelligence to mine customer data and improve

SPEEDY HIRE SALES & OPERATING PROFIT

plant availability, it introduced a mobile app allowing customers to hire equipment without having to go into a depot.

This flexibility has helped drive up revenue and utilisation rates, which helps profit margins as kit sitting idle in the depot doesn't earn the company anything.

The utilisation rate is currently 56% against 44% a couple of years ago but there is clearly scope to raise it further.

TARGETING AN IMPROVED RETURN ON CAPITAL

For the chief executive the key financial measure is return on capital employed (ROCE). This is a critical measure of the strength of a business.

From just 3.2% at the start of 2016 returns are already up to 12.3% and are well on their way to the medium-term target of 15%.

As well as raising returns by increasing sales to small and medium-sized customers and improving the utilisation rate, Speedy Hire is growing its higher-margin service business.

Services fall into three categories: consumables like saw blades and drill bits, training and testing.

In the year to 31 March 2018 service revenue grew by 16%, faster than hire revenue, accounting for just over a third of group turnover. In the six months to September service revenue again grew faster than hire revenue.

The most interesting part of the service business is testing, inspection and certification (TIC) which is carried out by Lloyds British, a Speedy Hire subsidiary.

Lloyds is over 200 years old and developed the first standard for testing and certifying chains and anchors. It is now the UK market leader in certifying a wide range of industrial equipment.

Speedy Hire doesn't split out Lloyds British in its results but TIC is a high-margin activity with firms like **Intertek (ITRK)** generating over 25% ROCE.

The UK TIC market is worth around £850m a year and related services could be worth another £600m putting the total potential market at £1.45bn a year.

MORE TO COME FROM LLOYDS BRITISH

Thanks to the cash flow from its hire operations and good working capital management Speedy Hire has a healthy balance sheet with minimal debt.

The chief executive is keen to grow this higher-margin TIC business and the half-year results state that the company will 'capitalise on market opportunities through value-enhancing acquisitions'.

This is a smart strategy as acquisitions will give Lloyds British even greater benefits of scale in a market with plenty of growth potential.

We like the business but would hold off buying until there is more certainty on how Brexit will play out. There are too many uncertainties regarding the UK construction market as present. (IC)

Meet the investment trust which invests in other trusts

BMO Managed Portfolio has both growth and income portfolios based on a collection of close-ended funds

Many investment trusts are diversified products, typically with portfolios made up of up to 100 individual companies. A trust which invests in other investment trusts arguably takes this to another level, potentially providing exposure to thousands of underlying investments.

You get a professional insight into the prospects and performance of a variety of funds by watching the purchases and divestments by the manager of a trust-of-trusts.

One such vehicle in this universe is the BMO Managed Portfolio trust, until recently known as the F&C Managed Portfolio Trust. This has both an income – **BMO Managed Portfolio Income (BMPI)** – and growth – **BMO Managed Portfolio Growth (BMPG)** share – underpinned by two separate underlying portfolios of around 40 close-ended funds.

> **If you make clear to the market you will buy shares and keep on buying, the market, and market makers, get the message**

MAKING THE SWITCH

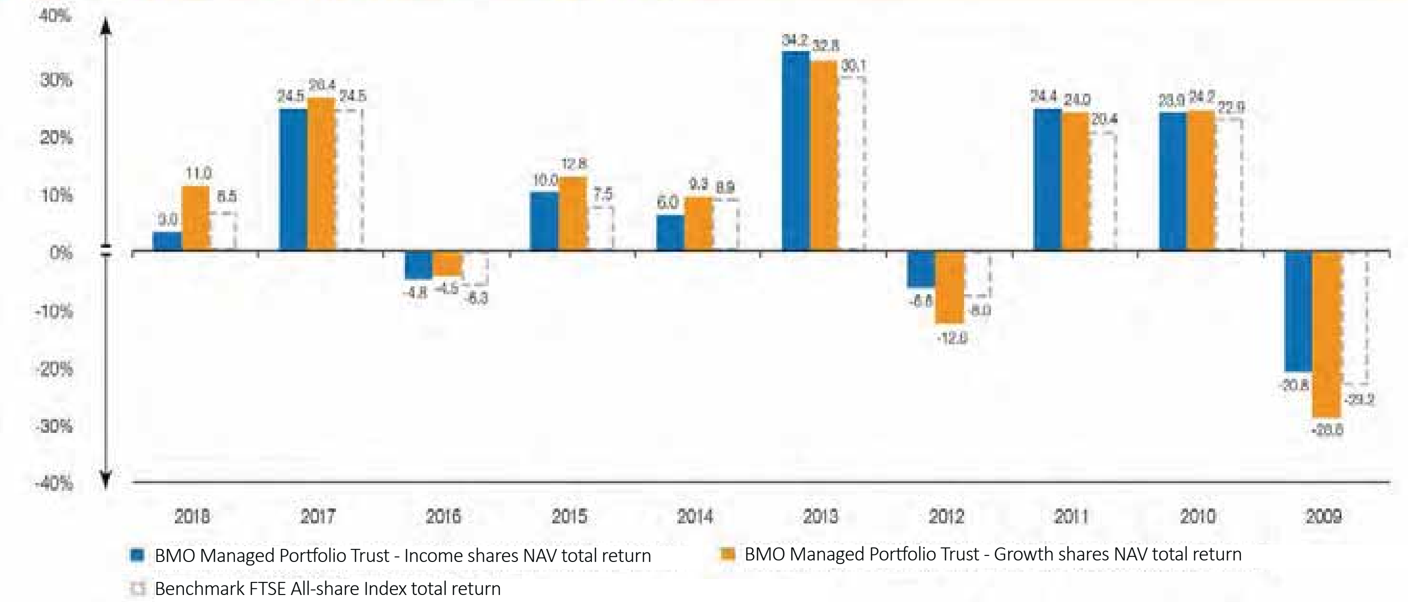
The trust now provides investors with a facility to shift from the growth to the income portfolio, which has a yield of more than 4% and pays a quarterly dividend, and vice versa.

For example, if you were nearing retirement and needed more income from your investment pot you could move funds to the income version from the growth shares which pay no dividend.

Manager Peter Hewitt has steered the trust since its inception in 2008. The performance has been decent with returns of 110.8% for the income portfolio and 102.5% in the growth portfolio through to the end of October 2018 against 85.8% for their shared benchmark, the FTSE All-Share.

The discrete performance shows the trust has only lost money in three of its financial years running to 31 May 2018, namely 2016, 2012 and, unsurprisingly, 2009 when the market was settling at its most recent low point. The ongoing charge is a little over 1%.

DISCRETE PERFORMANCE FOR THE FINANCIAL YEAR TO 31 MAY



Source: BMO

STAYING ON TOP OF THE DISCOUNT

Hewitt says a proactive approach has helped prevent the shares from languishing at a discount to net asset value. 'If you make clear to the market you will buy shares and keep on buying, the market, and market makers, get the message.'

Hewitt says that when it comes to acquiring trusts for the fund, buying at a discount is 'nice' but it is far from the most crucial factor. 'Getting the right underlying assets is much more important.'

Long-held constituents of the growth portfolio include a selection of technology-focused trusts including **Allianz Technology Trust (ATT)** and **Scottish Mortgage (SMT)**.

Another is life sciences fund **Syncona (SYNC)**, effectively spun out of the Wellcome Trust's investment arm, which Hewitt describes as a 'fantastic vehicle' although he recently top sliced his holding.

On the income side trusts like **Bankers (BNKR)** and **Law Debenture (LWDB)** have been held since inception.

WHAT HAS HEWETT BEEN BUYING AND SELLING?

Recent investments in Hewitt's growth portfolio include **Baillie Gifford UK Growth (BGUK)**, **Aurora Investment Trust (ARR)**, which has a value-based investment approach, and newly-launched emerging markets fund **Mobius Investment Trust (MMIT)**.

'We like the team from their time running the Templeton Emerging Markets trust,' says Hewitt on Mobius. 'Emerging markets are under the cosh, so it seemed like a good time to invest and the people behind it have a lot of their own cash invested.' Hewitt recently sold **Genesis Emerging Markets (GSS)**.

Capital preservation trusts like **Personal Assets Trust (PNL)** and **Ruffer (RICA)** have also joined the top 10 holdings in the growth portfolio as Hewitt reacts to the uncertain market backdrop.

Interestingly one of the trusts Hewitt continues to hold in the growth fund is **Woodford Patient Capital (WPCT)**.

Joking that he should have 'taken a closer look at the name', he acknowledges getting in at the IPO was a 'rubbish decision' in hindsight with the shares at 87.5p trading some way below the 100p issue price. But, he argues, there are some 'really interesting companies in the portfolio'.

On the income side Hewitt recently picked up stock in song royalty trust **Hipgnosis Song (SONG)**, and he sold BlackRock **Commodities Income (BRCI)** and infrastructure fund **HICL (HICL)**.

For 2019 Hewitt plans no further reductions in his UK exposure given the relative value offered by the market and he continues to favour trusts which are exposed to secular growth themes like biotechnology, technology and healthcare. (TS)

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WELCOME TO OUR NEW PODCAST

MONEY & MARKETS

A good investor keeps their ear to the ground. That's why *Shares* and AJ Bell have launched a new weekly podcast – so you can stay up to speed with everything investing.

Whether you listen on your commute or at your computer, 'AJ Bell Money & Markets' is a handy way to find out what's been happening in the financial world, so you can stay one step ahead.

In each episode you'll get our thoughts on topical financial issues – from pensions to pocket money, from stock markets to savings.

The podcast is presented by *Shares*' editor Daniel Coatsworth and AJ Bell's personal finance analyst Laura Suter. They are joined each week by special guests including various *Shares* journalists and other investment experts.

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HOW I INVEST:

Looking for long-term growth

Retail investor Paul and family are using investment funds to finance their future

Investing is a family affair for Paul from South Cheshire who is putting his money to work along with wife Marie and 10-year-old son James to fund what he calls 'proper life events'.

Completed by two-year-old spaniel Twix, the family are currently sitting on an investment portfolio worth a combined £310,000.

'It's about retirement planning for myself and my wife and for saving for the future, for our son James, university, housing, pensions,' Paul says, who like his wife only began his investment journey in earnest in his late 30s. Both are them are now in their late 40s.

The programme director for an IT firm adds: 'the approach for all investments is long-term growth, a pension for myself and Marie, and to give James as much of a "boost up" as possible before he is old enough to take charge of his own investments.'

INVESTING TAX EFFICIENTLY

Both Paul and his wife have individual ISAs and SIPPs with old occupational cash purchase pensions which have been transferred into SIPPs in all but one case.

Their experience in needing to make their own provision for retirement reflects the challenge facing their generation. 'No nice final salary schemes in our universe I'm afraid,' Paul adds.

He is a big proponent of not just Junior ISAs but also the Junior SIPP. 'People don't seem to know that if you have a SIPP for a child the Government will contribute to it in the same way as for an adult. They may have to wait a long time, but the "free" money cannot be ignored, right?'

I do have a worry about the Government fiddling with the rules (on pensions) over time

Paul says he invests through these vehicles for their tax efficiency with the ISAs providing an easily accessible source of 'emergency or life event' assets which can be liquidated when required.

'I do have a worry about the Government fiddling with the rules (on pensions) over time', he says. 'But as there is nothing I can do about that, it does not keep me awake at night.'

FOCUSED ON FUNDS

For the most part Paul invests in a collection of unit trusts, concentrated on the accumulation version where cash from dividends is automatically rolled up into more fund units.

The main exception is a single retail corporate bond that in Paul's words is 'just paying too much interest for it to be sold away'.

Paul says: 'In the past I've tried individual shares, ETFs (exchange-traded funds), retail bonds, investment trusts, warrants, PIBs (permanent interest-bearing shares), everything you can imagine. What I've learnt is that you can't guess or predict the market so it's best to spread your savings around to minimise risk'.

He considers funds useful for this reason as they help with diversification and 'you don't have to worry about dividend re-investment or looking across your weighting or other complicated methods… it's all done for you'.

He adds: 'I had massive fails with Telewest in the tech boom in 2000/01 and after I had learnt the lesson about single company equity investment in high-risk high-growth areas. I failed again by having "safe" slow and sensible bank shares in my portfolio eight years later in 2008. I lost 85% on Telewest and 50% of my investment on the banks.'

Paul says these 'tough experiences' mean he plans to adopt a buy and hold approach, sticking with the funds in which he is already invested.

A CLOSER LOOK AT THE PORTFOLIO

His portfolio includes Vanguard's range of LifeStrategy funds as well as **iShares Global Property (B670Q95)**, **BlackRock Natural Resources (B46KYQ5)**, **Vanguard US Equity Index (B5B71Q7)** and investment trust **Scottish Mortgage (SMT)** where he makes use of a dividend reinvestment plan.

The low-cost LifeStrategy funds provide diversified global exposure to bonds and shares.

He describes BlackRock Natural Resources as a conviction play 'waiting on the next commodities super-cycle', while the property fund provides exposure to an asset which, in his view, should be uncorrelated to equities.

On Scottish Mortgage, his other conviction selection, he says: 'I am in technology as a career, so it was nice to find a fund I empathised with. It's not based on fashion, has low charges for an active fund, and a reasonable track record. I like their "long termism"; James could be invested in this product for the next 40-odd years.'

I lost 85% on Telewest and 50% of my investment on the banks

Discover some of the most popular investments in Junior ISAs

New research shows the latest trends for children's investment accounts

Many parents use tax-efficient Junior ISA accounts to save for their children, but how do they decide where to invest for their children's future?

Junior ISA accounts can grow tax-free, and can be opened from birth, with parents and grandparents able to pay in money each year, with the current tax year's limit being £4,260.

The money is locked up until the child reaches the age of 18, at which point the child can decide what to do with the money – whether to keep it invested or cash it all in.

A study of a large sample of AJ Bell YouInvest customers for the 12 months to 30 September

2018 shows that just 7% of Junior ISA holders cashed out their accounts when they reached the age of 18. This low number is very encouraging as it suggests those still retaining the invested money are well-placed to start their own longer-term investing habit.

£12,000

This is the average value of a Junior ISA at the point of maturity (i.e. when a child turns 18)

Source: AJ Bell Youinvest accounts, 2018

At the age of 18, the average Junior ISA account among AJ Bell Youinvest customers had an average of almost £12,000 in it. The maximum amount someone could save into a Junior ISA, if they started from the launch of Junior ISAs in 2011 and saved the full limit each year, would be £31,468.

If parents had started from the child's birth using the Junior ISA's predecessor the Child Trust Fund, and still saved the maximum each year, they

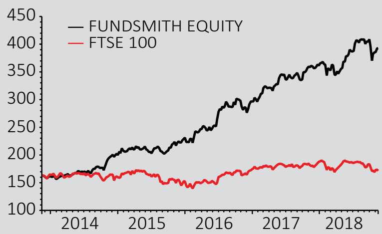
WHAT ARE THE POPULAR FUNDS IN JUNIOR ISAS?

Renowned fund managers, who have operated for a long time and have proven track records are undoubtedly popular for all investors, but particularly for parents who are investing their children's future money.

Terry Smith's **Fundsmith Equity (B41YBW7)** fund is among the most popular funds in AJ Bell Youinvest's Junior ISA accounts, while his newer **Fundsmith Emerging Equity Trust (FEET)** also has a decent following.

Nick Train's **Lindsell Train Global Equity (B3NS4D2)** fund has many fans, while Neil Woodford's **Woodford Equity Income (BLRZQ73)** and **Woodford Income Focus (BD9X6D5)** funds are hugely popular with parents saving for their kids.

His newer **Woodford Patient Capital Trust (WPCT)** also gets



a decent showing, although some 18-year-olds will not thank their parents for this particular investment, as it is currently down 15% since launch in 2015.

would have a pot worth up to £39,668 today – assuming zero growth.

HOW ARE PARENTS INVESTING THEIR CHILD'S ISA?

We've looked at the investment make-up of AJ Bell YouInvest Junior ISA customers who reached the age of 18 in the past year. This means the accounts we're looking at represent the final Junior ISA pot that many will end up with, and also reflect the growth in investments in the previous years.

Almost a third of the money is invested in funds. Investment trusts are also popular, with 16% of all Junior ISA assets in them, while direct UK shares account for 16%, and AIM-quoted shares accounting for another 4%.

Cheaper 'trackers' or exchange-traded funds (ETFs) account for another 16%, while bonds account for less than 1% of the total sums invested, far below the proportion invested in shares listed overseas, which account for nearly 3% of all assets.

Around 15% of the money is sitting in cash. The level of cash you'd want in your account depends on what you plan to do with the money, and when you envisage your child using it.

It's understandable that parents will want to keep a certain portion of the pot in cash, to have a safe haven asset and de-risk the portfolio. It is also likely that some parents have gradually sold investments as their child neared the age of 18, in anticipation of them using the money or cashing out the account.

A DECENT APPETITE FOR RISK

Parents are willing to take risk with their children's savings pots – which makes sense considering the money is locked away for up to 18 years, and so there is time to ride out the market highs and lows.

There is a smattering of biotech and healthcare trusts, including **Biotech Growth Trust (BIOG)** and **Worldwide Healthcare (WWH)**. A handful of parents even plumped for holdings in **Vinacapital Vietnam Opportunity (VOF)**, an investment trust focused entirely on Vietnam.

Technology holdings are a big feature among Junior ISAs, with tech-heavy **Scottish Mortgage (SMT)** by far the most popular holding for parents.

These parents will be happy with their choice, as the trust has risen by 631% in value in the past 10 years – turning a £4,000 investment into almost £30,000. **Alllianz Technology Trust (ATT)** and **Polar Capital Global Technology (B42W4J8)** are other popular picks.

Individual technology stocks also feature, with Google's parent company Alphabet a regular holding, as is tech giant Apple and social media giant Facebook. Netflix and Amazon are less popular but still feature, while just a handful of portfolios hold car maker Tesla – possibly because it's a newer company.

However, a large number of parents pick the option of outsourcing the investment decisions and buy one-stop-shop funds, which split the investments across different asset classes and geographies. Vanguard's LifeStrategy range of portfolios and AJ Bell's own passive range of funds are hugely popular with time-strapped parents who don't want to make investment choices themselves.

Laura Suter, personal finance analyst, AJ Bell

POPULAR STOCKS IN JUNIOR ISAS

AJ Bell Youinvest's Junior ISA customers seem to be attracted to many FTSE 100 giants, with pharmaceutical companies **AstraZeneca (AZN)** and **GlaxoSmithKline (GSK)**, oil giants **BP (BP.)** and **Royal Dutch Shell (RDSB)**, UK bank **Lloyds (LLOY)**, consumer goods giant **Unilever (ULVR)** and telecoms firm **Vodafone (VOD)** among the popular holdings.

British mining stock **Sirius Minerals (SXX)** has also proved popular with investors, appearing in decent number of portfolios. Over five years the share price is up 274%, although it has slumped recently.

'Can I put my stipend in my stakeholder pension?'

AJ Bell expert Tom Selby helps to clarify the rules

Dean, address not given

'I'm a clergyman in a final salary pension scheme. Can I still put my full annual stipend into my stakeholder pension, or is there some notional value placed upon the DB (defined benefit) membership?'

Tom Selby, AJ Bell senior analyst, replies:

For those unfamiliar with the term, a stipend is a regular fixed sum paid as a salary or as expenses to a clergyman, teacher or public official.

Savers in the UK receive tax relief on money paid into a pension, with most subject to an annual allowance (including tax relief) of £40,000.

You are only allowed to personally pay in 100% of your relevant UK earnings into a pension in any tax year. So someone who is paid £30,000, for example, can't make a total annual pension contribution of more than £30,000.

Those earning above £150,000 may have a lower annual allowance – you can find more information on how this so-called 'taper' works **here.**

In addition, anyone who has taken taxable income from their defined contribution pension from age 55 has their annual allowance reduced to just £4,000. This does not apply to

defined benefit pensions like yours.

Whatever the level of your annual allowance, it will apply across all your pension arrangements – including defined benefit and defined contribution. Stakeholder pensions are simply a form of defined contribution pension where charges are capped.

Working out how much of your defined contribution annual allowance you have used is relatively straightforward – it's simply the amount that has gone into your fund, including tax relief, during the year.

Figuring out how much annual allowance you have used in your defined benefit scheme is a little trickier.

First you need to take the value of your benefits at the start of the year and multiply it by 16. Then you have to add any lump sum entitlement, before finally increasing your pension value by the CPI inflation figure from the previous September. This provides your 'opening value'.

Next you need take the total amount of pension built up during the year and multiply this amount by 16. You then add any lump sum entitlement built up in the pension. You may also need to make adjustments if you have transferred money in or out of the account. This gives you the 'closing value'.

The difference between the 'opening value' and 'closing value' is the amount of annual allowance used up in your defined benefit scheme.

If you speak to your defined benefit scheme administrator they should be able to do the sums for you.

If you do breach the annual allowance, HMRC will levy a charge designed to claw back any tax relief you have received during the year.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

Send an email to **editorial@sharesmagazine.co.uk** with the words 'Retirement question' in the subject line. We'll do our best to respond in a future edition of *Shares*.

Please note, we only provide guidance and we do not provide financial advice. If you're unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

Are the chip stocks sending a red alert signal?

NVIDIA's warning may point to bigger problems in the semiconductor space

By Russ Mould, investment director, AJ Bell

Alongside electric car maker Tesla, global graphics processing unit leader NVIDIA has acquired quasi-FAANG status, helped by the phenomenal capital gains which it has provided to investors.

This makes the company – and its sudden travails, in the form of a profit warning (15 November) and steep share price slide – interesting to this column for two reasons.

First, it puts further pressure on the tech sector, which has been a rare source of juicy capital gains for investors in 2018.

Second, it brings silicon chip stocks back into the spotlight. They are interesting because their main benchmark, the Philadelphia Semiconductor index, or SOX, has a good record as an indicator for global economic and financial market health that dates back to its inception in 1994.

But this does not mean investors can ignore NVIDIA's big profit warning, which cited indigestion in the video consoles market and also a slowdown in demand from makers of Bitcoin mining equipment.

The alert means that a stunning run of increases in quarterly sales and profit is about to come to a crashing end, with founder and chief executive Jensen Huang forecasting a 7% year-on-year drop in sales and a 28% year-on-year plunge in operating profit for the fourth quarter.

DIGGING A HOLE

After the disappearance of ARM, ARC, Imagination, Wolfson, CSR and PureWafer, the UK stock market is not blessed with exposure to the global semiconductor industry, which has annual global sales of more than $400bn. **IQE (IQE:AIM)** is one of the UK's remaining quoted players.

NVIDIA'S RUN OF SALES AND PROFIT GROWTH LOOKS TO BE HITTING A SPEED BUMP

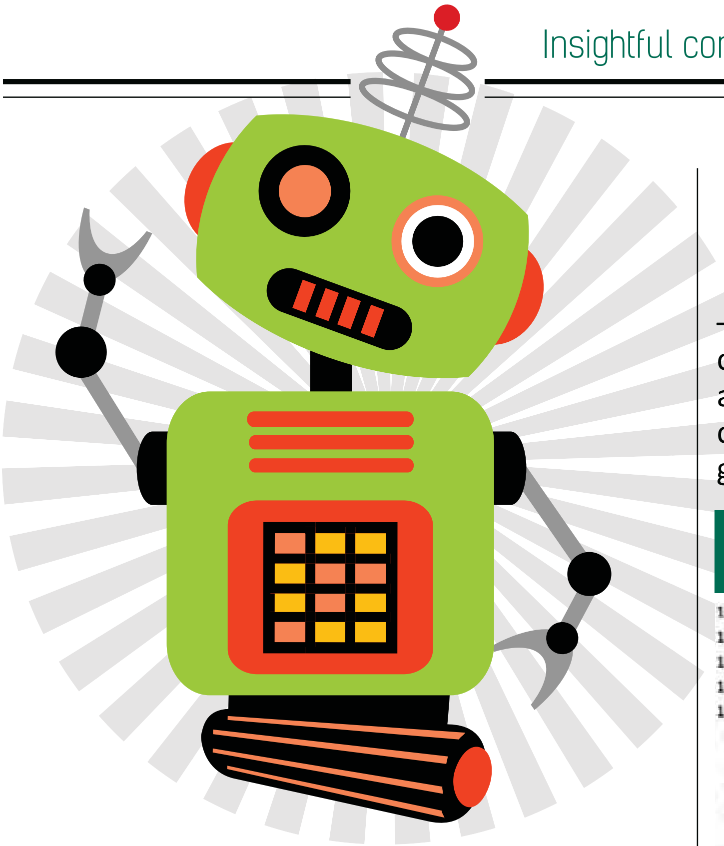
Source: NVIDIA accounts, Q4 estimate based on management guidance issued on 15 November 2018

THREE ISSUES

This is not to say that NVIDIA cannot bounce back but investors must now mull over three issues.

1. **Is it time to keep buying on the dips?** A stock market bull run that is nearly 10 years old has conditioned many market participants to use any share price weakness as a chance to pile back in.
   Like all investment strategies this one works well, until it doesn't.
   It may not be obvious from the long-term share price chart but NVIDIA's shares fell by more than 80% in both of the 2001-03 and 2007-09 bear markets. A repeat this time would take NVIDIA back to barely $60 – still miles below the $164 price at the time of writing.
2. **Is this a stock-specific situation or indicative of wider problems for end-demand for silicon chips?** It is tempting to say this is a situation that lies solely with NVIDIA, given the damage done by relative niche markets such as bitcoin mining equipment. But NVIDIA has not been alone in warning of softer end markets.

A string of Apple suppliers have coughed up disappointing results, including Japan Display, Lumentum and AMS; while Texas Instruments,

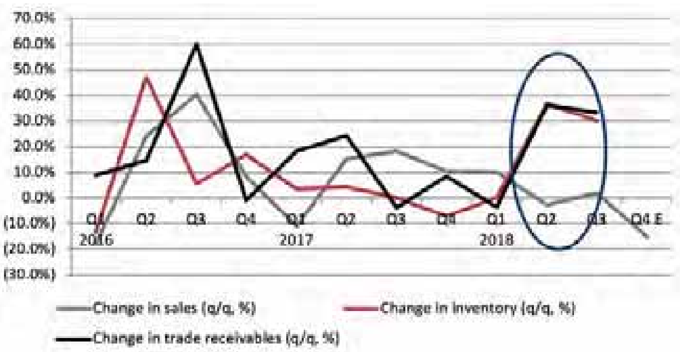


Infineon and STMicroelectronics have all issued cautionary outlooks.

This feels like it could be broader-based and investors must now keep an eye on NVIDIA's quarterly balance sheets. A second-quarter jump in inventories and trade receivables warned of a possible slowdown and now it has come to pass, with inventories and receivables rising must faster than sales yet again.

Tech-stock bulls will want to see this bulge of finished parts start to diminish to suggest this is just a blip and not an end-of-cycle downturn.

LOOK AT THE JUMP IN INVENTORIES AND RECEIVABLES



NVIDIA accounts, Q4 estimate based on management guidance issued on 15 November 2018

3. **What, if anything, does this mean for stock markets more generally?** NVIDIA is a leading member of the SOX index, which peaked before the wider US stock market in both 2000 and 2007 and bottomed before headline indices such as the S&P 500 began to find their footing in 2002 and 2009.

This is because silicon chips – semiconductors – are everywhere. They can be found in cars and computers, smartphones and tablets, video games and robotics, and even display screens and data centres, so they are good proxy for economic growth and broader end-market demand.

THE SOX INDEX PEAKED BEFORE BROADER BENCHMARK STOCK INDICES IN 2000 AND 2007

Source: Refinitiv data

In addition, chip stocks are traded as momentum and growth stocks, doing well when earnings estimates are going up and badly when they are going down. As a result, the SOX can be a good guide to financial market sentiment more generally.

THE SOX INDEX PEAKED IN MARCH

Source: Refinitiv data

The SOX had rallied going into the NVIDIA report so it will be interesting to see if the index can shrug off the disappointment as we head into the key festive gadget selling season.

Buyers on the dips will certainly be hoping so, although they may note with some trepidation that the SOX index has yet to recapture the highs reached in March of this year.

Should you worry about ETFs that only track a handful of stocks?

Portfolio concentration is an underappreciated risk with passive investment products

If Samsung's shares have a bad day, so does iShares MSCI South Korea as 22.4% of its assets are made up of that stock

One of the major attractions of exchange-traded funds (ETFs) is that they offer investors the opportunity to track virtually any market, asset or industry they choose. But investors should be aware that the more far-flung or niche the index they choose to track, the fewer stocks it is likely to contain.

ETFs following unusual fields can often invest in just a handful of names and that can seriously ramp up the risk for investors.

An ETF which follows the S&P 500 index, for example, is tracking the fortunes of 500 different companies. That means if the share price of one of the companies in this index plunges, the effect on the index as a whole is limited. The largest stock in the S&P 500 is Apple, which accounts for 4.4% of the index.

But less developed stock markets or indices have far fewer constituents. **Expat Bulgaria Sofix ETF (BGX)**, for example, has just 15 shares in its portfolio. The three largest companies in the index by weighting account for more than 37% of assets.

> **Just because an index is particularly concentrated, it doesn't automatically mean you should not invest**

Even where an ETF portfolio contains a decent number of names, there may still be concentration risk. **iShares MSCI South Korea ETF (0JEW)**, for example, has 115 stocks in its portfolio, but some 22.4% of its assets are in Samsung Electronics. That means if Samsung's shares have a bad day, it will have a significant impact on the performance of the ETF.

Examples such as these highlight the importance of checking under the bonnet of any investment before committing your money to it. ETFs by their very nature suggest diversification, but that may be difficult to achieve in particular assets or regions.

From a regional perspective, emerging markets are often more prone to this type of concentration risk. This is because there are often fewer

Vodafone accounts for nearly 20% of Amundi MSCI Europe Telecom Services portfolio

companies listed on their stock markets and a handful of market leaders may account for a disproportionate amount of the index.

While an emerging market fund manager can make a decision to deviate from those weightings and spread his assets more widely, an ETF simply follows the index.

Caroline Baron, head of ETF sales at Franklin Templeton, says: 'There are 24 countries in the MSCI Emerging Market index but the top three countries – China, South Korea and Taiwan – represent 56% of the portfolio and the top three underlying holdings represent 13% of the index, which might be an issue if one of those starts to not perform.

'We tend to see a similar pattern in many indices and this is why it might be important for investors to understand those potential risks when constructing a diversified portfolio.'

NICHE INDUSTRY FOCUS

Thematic products or those which track specific industries or trends may be more concentrated too, because there may be fewer companies operating within the space in which they are focused.

Amundi MSCI Europe Telecom Services ETF (CT5) has just 18 companies in its portfolio – all involved in the European telecoms industry. The largest holding, **Vodafone (VOD)**, accounts for 19.9% of the portfolio and the top three holdings account for more than 50% of assets. Tracking a specific sector such as this one comes with the risk that regulation affecting the entire industry could change, sending all the holdings plunging at the same time.

Another example is **iShares Global Timber and Forestry ETF (WOOD)**, which tracks just 25 companies in the industry, albeit they are spread across 16 different countries.

Another reason that ETF concentration is an important consideration is because it should have a major bearing on why you choose an investment in the first place.

You might, for example, select a FTSE 100 or S&P 500 tracker because you feel confident about the overall prospects for those markets. But when a fund has a quarter of its assets in one single stock, you need to feel confident about the prospects for that specific company.

Baron suggests that so-called smart beta ETFs may be a way of alleviating some of this concentration for investors who do want to use a tracker fund to access these regions.

Smart beta ETFs inject a dose of active management into passive investing by putting certain rules or a particular focus in place, such as limiting weighting or targeting stocks which generate a certain yield.

Baron adds: 'Investors do need to look under the bonnet to fully understand what they are getting into but the good thing about ETFs is that their risks can be assessed very easily because all of their holdings are publicly available on a daily basis.' This is different to active funds, which typically only make their largest 10 holdings available.

Just because an index is particularly concentrated, it doesn't automatically mean you should not invest – after all a gold ETF only tracks the price of one thing: gold.

But it does mean you should have a very strong conviction in that index and be sure to do some research on the individual holdings first. (HB)

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Full-year results

27 Nov: Shaftesbury, Topps Tiles, UDG Healthcare. **29 Nov:** Britvic, Daily Mail and General Trust, Thomas Cook.

Half-year results

27 Nov: De La Rue, Pets at Home. **28 Nov:** RPC, Telford Homes. **29 Nov:** BCA Marketplace, Greene King, PayPoint

Trading Statements

26 Nov: Intertek.

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